Articles

CHOICE OF LAW CLAUSES AND THEIR PREEMPTIVE EFFECT UPON THE FEDERAL ARBITRATION ACT: RECONCILING THE SUPREME COURT WITH ITSELF

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INTRODUCTION

Frequently, a contract that contains an arbitration clause, providing for arbitration of disputes that may arise between the contracting parties, will also contain a choice of law clause, providing that the laws of a designated state shall govern the contract. The interrelationship between these two clauses poses a potential dilemma. The designated state's arbitration laws may prevent, limit or delay arbitration to an extent not permitted by the Federal Arbitration Act (the FAA) which, absent the choice of law clause, would preempt those restrictive state laws. In such a situation, whether a dispute arising between the contracting parties must be submitted to arbitration depends upon whether the choice of law clause effectively bypasses the preemptive effect of the FAA. The United States Supreme Court has attempted to resolve this dilemma in two separate cases. Unfortunately, the holdings are in apparent conflict. The Court's footnoted attempt to reconcile the two cases is perfunctory, vague and supported by reasoning that is incompatible with the purposes of the FAA. As a result, there is division and confusion among lower courts as to the state of the law. This Article critiques the two cases, describes how they have been applied by lower courts, and proposes a reconciliation that affords to each case a clear and distinct domain, while allowing the policies underlying the FAA to be promoted.

I. OVERVIEW

Prior to the passage of the FAA in 1925,[1] courts treated contractual agreements to arbitrate disputes with overt hostility.[2] Such agreements were

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1. Federal Arbitration Act., ch. 213, 43 Stat. 883 (1925) (codified as amended at 9 U.S.C. §§ 1–16 (1994)).

2. The FAA's "purpose was to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts...." Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24 (1991).

considered either invalid[3] or valid but devoid of effective remedies against a recalcitrant party.[4] Enforcement through specific performance was denied,[5] resolution of the dispute through litigation was not precluded,[6] and only

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The root causes for that hostility have remained a matter of conjecture. Courts continually rested their refusal to honor arbitration agreements on the ground that attempts to oust the courts of jurisdiction violated public policy, without explaining the underlying rationale. *See, e.g.*, San Francisco Sec. Corp. v. Phoenix Motor Co., 25 Ariz. 531, 539, 220 P. 229, 231 (1923); W.H. Blodgett Co. v. Bebe Co., 214 P. 38, 40 (Cal. 1923); Steinhardt v. Consolidated Grocery Co., 86 So. 431, 431 (Fla. 1920); Cochrane v. Forbes, 153 N.E. 566, 567 (Mass. 1926); Aaberg v. Minnesota Commercial Men's Ass'n, 189 N.W. 434, 434 (Minn. 1922); Berkovitz v. Arbib & Houlberg, Inc., 183 N.Y.S. 304, 306 (App. Div. 1920); Linda R. Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1309 (1985). The House report accompanying the FAA assumed the hostility was spawned by judicial jealousy.

Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts. H.R. REP. NO. 96, 68th Cong., 1st Sess. 1–2 (1924).

Judicial hostility may have stemmed from personal monetary concerns. The rules decreeing arbitration agreements to be unenforceable had their origin at a time when English judges received fees for the cases they heard. Refusing to honor arbitration agreements preserved and protected their source of financial remuneration. *See* Alison B. Overby, Note, *Arbitrability of Disputes Under the Federal Arbitration Act*, 71 IOWA L. REV. 1137, 1139 (1986); Earl S. Wolaver, *The Historical Background of Commercial Arbitration*, 83 U. PA. L. REV. 132, 141 (1934).

It has also been strongly asserted that the refusal to enforce arbitration agreements was rooted in fair and pragmatic judicial policy. Parties commonly posted a bond as security for their agreement to arbitrate. Failure to comply with the agreement allowed a suit upon the bond which was of a sufficient sum to fully compensate the aggrieved party. With the passage of the Statute of Fines & Penalties in 1687, that remedy was no longer viable. Only then did the need to enforce arbitration agreements arise, but the courts blindly adhered to outdated precedent. *See* Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595, 604–05 (1928).

Neither ancient jealousies nor the power of precedent, however, fully explain the centuries' long resistance to arbitration. "Perhaps the true explanation is the hypnotic power of the phrase, 'oust the jurisdiction.' Give a bad dogma a good name and its bite may become as bad as its bark." Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 984 (2d Cir. 1942).

3. The Howick Hall, 10 F.2d 162, 162 (E.D. La. 1925); Jefferson Fire Ins. Co. v. Bierce & Sage, Inc., 183 F. 588, 590 (E.D. Mich. 1910); Employee's Benefit Ass'n & Ariz. Mining Co. v. Johns, 30 Ariz. 609, 619, 249 P. 764, 767 (1926); *W.H. Blodgett Co.*, 214 P. at 39; Cocalis v. Nazlides, 139 N.E. 95, 97–98 (Ill. 1923); Evans v. Chamber of Commerce, 91 N.W. 8, 10 (Minn. 1902).

4. "It is true enough that the executory contract to arbitrate is not usually denounced as per se illegal, but the rulings amount to the same thing in the end...." Atlantic Fruit Co. v. Red Cross Line, 5 F.2d 218, 220 (2d Cir. 1924).

5. "[A]n agreement to refer to arbitration will not be enforced in equity, and will not be sustained as a bar to an action at law or a suit in equity." Brocklehurst & Potter Co. v. Marsch, 113 N.E. 646, 649 (1916). *Accord Kulukundis Shipping Co.*, 126 F.2d at 983; N.P. Sloan Co. v. Standard Chem. & Oil Co., 256 F. 451, 454 (5th Cir. 1918); Dickson Mfg. Co. v. American Locomotive Co., 119 F. 488, 490 (M.D. Pa. 1902); National Contracting Co. v. Hudson River Water Power Co., 63 N.E. 450, 451 (1902). MARTIN DOMKE, THE LAW AND PRACTICE OF ARBITRATION § 3.01 (1968); Frank D. Emerson, *History of Arbitration Practice and Law*, 19 CLEV. ST. L. REV. 155, 161 (1970).

6. *Brocklehurst & Potter*, 113 N.E. at 649. Many courts recognized an exception to this rule if the contract expressly provided that arbitration of specified facts essential to a cause of action was a "condition precedent" to the right to sue. Failure to arbitrate those facts would bar a claim upon the underlying cause of action. *See, e.g.*, Headley v. Aetna Ins. Co., 80 So. 466, 467 (Ala. 1918); *Employee's Benefit Ass'n*, 30 Ariz. at 619, 249 P. at 767; *W.H. Blodgett Co.*, 214 P. at 39–40; *Cocalis*, 139 N.E. at 97; *Williams*, 194 N.Y.S. at 801; Wolaver, *supra* note 2,

nominal damages were awarded for breach.[7]

The FAA mandated a cessation of that hostility for arbitration agreements incorporated within contracts involving commerce[8] by declaring those agreements to be valid, irrevocable and enforceable.[9] Subsequent to its passage, state legislatures enacted their own statutes[10] recognizing the validity and enforceability of agreements to arbitrate.[11] Most of these state statutes, however, contain exemptions and restrictions not found in the FAA. Many expressly exclude from their coverage particular types of disputes such as those involving insurance,[12] health care,[13] consumer contracts,[14] adhesion contracts,[15] personal injury,[16] or employment.[17] Others impose procedural conditions upon

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at 143.

7. *Atlantic Fruit Co.*, 5 F.2d at 220; Munson v. Straits of Dover S.S. Co., 99 F. 787, 789–90, (S.D.N.Y. 1900) (stating that actual damages were denied because they were "too loose, indefinite and incapable of verification."); Stern Co. v. Friedman, 201 N.W. 961, 964 (1925); Hopedale Elec. Co. v. Electric Storage Battery Co., 77 N.E. 394, 397 (N.Y. 1906); Martin v. Vansant, 168 P. 990, 995 (Wash. 1917); Sayre, *supra* note 2, at 604.

8. The FAA governs written agreements to arbitrate "in any maritime transaction or a contract evidencing a transaction involving commerce...." 9 U.S.C. § 2 (1994). *See* H.R. REP. NO. 96, *supra* note 2, at 1–2.

9. 9 U.S.C.A. § 2 (1994).

10. New York was the only state that, prior to the passage of the FAA, adopted legislation which broadly enforced arbitration agreements. Act of Apr. 19, 1920, ch. 275, 1920 N.Y. Laws 803 (codified as amended at N.Y. CIV. PRAC. L. & R. 7501–7514) (McKinney 1980 & Supp. 1996). *See* Sarah R. Cole, *Incentives and Arbitration: The Case Against Enforcement of Executory Arbitration Agreements Between Employers and Employees*, 64 UMKC L. REV. 449, 465–66 (1996); Hirshman, *supra* note 2, at 1312.

11. "Starting with the New York Arbitration Act of 1920, and followed by the United States Arbitration Act of 1925 (also known as the Federal Arbitration Act)...Congress and most state legislatures have essentially repudiated the traditional judicial hostility toward arbitration." Leo Kanowitz, *Alternative Dispute Resolution and the Public Interest: The Arbitration Experience*, 38 HASTINGS L.J. 239, 256 (1987).

Two states, Oklahoma and West Virginia, have failed to enact legislation declaring the general validity and enforceability of agreements to arbitrate disputes that may arise between contracting parties. The Supreme Court of West Virginia has achieved that effect by changing the common law of that state to require judicial enforcement of arbitration agreements. Board of Educ. of Berkeley v. W. Harley Miller, Inc., 236 S.E.2d 439, 447 (W. Va. 1977). Alabama courts are unable to take that approach, as the common law hostility has been codified. ALA. CODE § 8–1–41(3) (1993).

In State v. Nebraska Ass'n of Public Employees, 477 N.W.2d 577, 580 (Neb. 1991), the Nebraska Supreme Court held that Nebraska's statute enforcing agreements to arbitrate future disputes was in violation of that state's constitution.

12. ARK. CODE ANN. § 16–108–201 (Michie Supp. 1995); KAN. STAT. ANN. § 5–401 (1995); KY. REV. STAT. ANN. § 417.050(2) (Michie/Bobbs–Merrill Supp. 1996); MO. ANN. STAT. § 435.350 (Vernon Supp. 1997); MONT. CODE ANN. § 27–5–114 (1995); OKLA. STAT. ANN. tit. 15, § 802 (West 1993); R.I. GEN. LAWS § 10–3–2 (Supp. 1995).

13. OHIO REV. CODE ANN. § 2711.23(B) (Anderson 1992); S.C. CODE ANN. § 15–48–10(b)(3) (Law. Co-op. Supp. 1995).

14. IND. CODE ANN. § 34–4–2–1(b) (Burns 1986); MONT. CODE ANN. § 27–5–114(2)(b) (1995) (for goods or services in which the consideration was $5000 or less); N.Y. GEN. BUS. LAW ANN. § 399–c.2 (McKinney 1996).

15. IOWA CODE ANN. § 679A.1(2)(b) (West 1987); MO. ANN. STAT. § 435.350 (Vernon 1992); NEB. REV. STAT. § 25–2602(b) (1995).

16. ARK. CODE ANN. § 16–108–201(b); KAN. STAT. ANN. § 5–401(c)(3) (1995) (tort claims); MONT. CODE ANN. § 27–5–114(2)(a) (1995); NEB. REV. STAT. § 25–2602 (1995).

17. ARK. CODE ANN. § 16–108–201(b) (Michie 1987); IDAHO CODE § 7–901 (1996); IOWA CODE ANN. § 679A.1(2)(b) (West 1987); KAN. STAT. ANN. § 5–401(c)(2) (1995); KY. REV. STAT. ANN. § 417.050(1) (Michie Supp. 1996); LA. REV. STAT. ANN. § 9:4216 (West 1991); R.I. GEN. LAWS § 10–3–2. The extent to which employment contracts are included within the ambit of the FAA has not been clearly resolved. *See infra* note 44.

their enforceability, requiring that the arbitration agreement be worded in designated language,[18] written in specified sized print,[19] located in a particular place[20] or signed by the parties' attorneys.[21] Some jurisdictions permit a permanent or temporary stay of arbitration if related disputes that are not subject to arbitration are in the process of being litigated.[22]

Judicial rules implementing these state statutes may also be more restrictive than those developed under the FAA. They may require the court, rather than the arbitrator, to decide preliminary issues such as whether the statute of limitations is a bar to the underlying claim,[23] when under the FAA those issues are for the arbitrator to decide.[24] They may narrowly interpret the ambit of an ambiguous arbitration clause,[25] when under the FAA doubts are resolved in favor of arbitration.[26] They may limit the arbitrator's power to award certain remedies, such as punitive damages,[27] when under the FAA no such limitation applies.[28] They may find that a party has waived the right to arbitrate by engaging in conduct inconsistent with that right,[29] such as by participation in litigation, when under the FAA the conduct must also have substantially prejudiced the opposing party before a waiver will be found.[30]

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18. *See., e.g.*, CAL. CIV. PROC. CODE § 1295(b) (West 1982) (Agreements to arbitrate health care claims must be in bold print, immediately before the signature line, advising parties they are waiving right to jury trial); MO. ANN. STAT. § 435.460 (Vernon 1992) (Agreement to arbitrate must be in ten point capital letters adjacent to or above the signature line, advising parties they are agreeing to binding and enforceable arbitration).

19. CAL. CIV. PROC. CODE § 1295(b); MO. ANN. STAT. § 435.460; MONT. CODE ANN. § 27–5–114(4) (1995) (agreement to arbitrate must be in capital letters on first page of contract); S.C. CODE ANN. § 15–48–10(a) (Law Co-op. Supp. 1995) (agreement to arbitrate must be in capital letters on first page of contract).

20. CAL. CIV. PROC. CODE § 1295(b); MO. ANN. STAT. § 435.460; MONT. CODE ANN. § 27–5–11(4).

21. TEX. CIV. PRAC. & REM. CODE ANN. § 171.001(b) (West Supp. 1996) (agreement to arbitrate certain consumer transaction disputes must be signed by the parties' attorneys).

22. CAL. CIV. PROC. CODE § 1281.2(c) (West 1982); Lawrence St. Partners v. Lawrence St. Venturers, 786 P.2d 508, 511 (Colo. Ct. App. 1989): IND. CODE ANN. § 34–4–2–3(f) (Burns 1986).

23. *See, e.g.*, Wynn v. Metro. Property & Cas. Ins. Co., 635 A.2d 814, 815 (Conn. 1994); Smith Barney & Co. v. Luckie, 647 N.E.2d 1308, 1313 (N.Y. 1995); Greenwood Int'l, Inc. v. Greenwood Forest Prods., Inc., 814 P.2d 528, 529 (Or. Ct. App. 1991).

24. *See, e.g.*, Cogswell v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 78 F.3d 474, 478 (10th Cir. 1996); Shearson Lehman Hutton, Inc. v. Wagoner, 944 F.2d 114, 121 (2d Cir. 1991); County of Durham v. Richards & Assocs., Inc., 742 F.2d 811, 815 (4th Cir. 1984).

25. *See, e.g.*, Trump v. Refco Properties 605 N.Y.S.2d 248, 250 (App. Div. 1993) (A dispute is not arbitrable unless the agreement "'unequivocally encompasses the subject matter of the particular dispute.'") (quoting Bowmer v. Bowmer, 428 N.Y.S.2d 902, 905 (1980)); Hazleton Area Sch. Dist. v. Bosak, 671 A.2d 277, 282 (Pa. Commw. Ct. 1996). *See also* Victoria v. Superior Ct., 710 P.2d 833, 838–40 (Cal. 1985) (holding that in a health care contract with adhesive characteristics, ambiguities as to the scope of an arbitration clause must be resolved against the drafter).

26. *See, e.g.*, First Options of Chicago, Inc. v. Kaplan, 115 S. Ct. 1920, 1924 (1995); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24–25 (1983).

27. United States Fidelity & Guar. Co. v. DeFluiter, 456 N.E.2d 429, 432 (Ind. Ct. App. 1983); Shaw v. Kuhnel & Assocs., Inc., 698 P.2d 880, 882 (N.M. 1985); Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793, 794 (1976).

28. Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212, 1218 n.7 (1995). *See supra* note 138 and accompanying text.

29. *See, e.g.*, Hough v. JKP Dev., Inc., 654 So. 2d 1241, 1242 (Fla. Dist. Ct. App. 1995); Cencula v. Keller, 504 N.E.2d 997, 999 (Ill. App. Ct. 1987); North West Mich. Constr., Inc. v. Stroud, 462 N.W.2d 804, 805 (Mich. Ct. App. 1990).

30. *See, e.g.*, Doctor's Assocs., Inc. v. Distajo, 66 F.3d 438, 456 (2d Cir. 1995);

Furthermore, a state's liberal arbitration laws may be superseded by a specific state statute that mandates judicial resolution of claims arising under that statute.[31]

The extent to which the FAA preempts a state's restrictive arbitration laws, in the absence of a choice of law clause, was addressed in a series of United States Supreme Court cases commencing in 1983 with the case of *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*[32] and followed by *Southland Corp. v. Keating,*[33] *Perry v. Thomas,*[34] *Allied-Bruce Terminix Cos. v. Dobson,*[35] and *Doctor's Associates, Inc. v. Casarotto.*[36] These cases collectively declare that state as well as federal courts are bound by the provisions of the FAA concerning the enforceability of arbitration agreements in contracts that involve commerce.[37] Congress intended the FAA to reach all contracts within its power to regulate[38] and, therefore, a contract will be deemed to involve commerce when, in fact, it affects commerce.[39] A state law, whether of statutory or judicial origin, may not impose restrictions upon the enforceability of arbitration agreements that exceed those provided by the FAA.[40] While states may apply general principles of contract law to invalidate arbitration agreements,[41] they may not apply special arbitration specific rules to

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PaineWebber Inc. v. Faragalli, 61 F.3d 1063, 1069 (3d Cir. 1995); Commercial Union Ins. Co. v. Gilbane Bldg. Co., 992 F.2d 386, 390 (1st Cir. 1993); Hoffman Constr. Co. v. Active Erectors & Installers, Inc., 969 F.2d 796, 798 (9th Cir. 1992); Walker v. J.C. Bradford & Co., 938 F.2d 575, 577 (5th Cir. 1991). IAN R. MACNEIL, RICHARD E. SPEIDEL & THOMAS I. STIPANOWICH, FEDERAL ARBITRATION LAW § 21.3 (1995). Only the Seventh Circuit has ruled that prejudice is not required. Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc., 50 F.3d 388, 390 (7th Cir. 1995) (holding 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..." irrespective of the absence of prejudice).

31. *See, e.g.*, Keating v. Superior Ct., 645 P.2d 1192, 1198 (Cal. 1982), *rev'd sub nom.* Southland Corp. v. Keating, 465 U.S. 1, 17 (1984); Lambdin v. District Ct., 903 P.2d 1126, 1129 (Colo. 1995); Bill Butler Assocs. v. New Eng. Sav. Bank, 611 A.2d 463, 465–66 (Conn. Super. Ct. 1991).

32. 460 U.S. 1 (1983).

33. 465 U.S. 1 (1984).

34. 482 U.S. 483 (1987).

35. 115 S. Ct. 834 (1995).

36. 116 S. Ct. 1652 (1996).

37. Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983); Southland Corp. v. Keating, 465 U.S. 1, 15–16 (1984); Perry v. Thomas, 482 U.S. 483, 489 (1987); Allied-Bruce Terminix Cos. v. Dobson, 115 S. Ct. 834, 839 (1995); Doctor's Assocs., Inc. v. Casarotto, 116 S. Ct. 1652, 1655–56 (1996). *See generally* Thomas E. Carbonneau, *The Reception of Arbitration in United States Law*, 40 ME. L. REV. 263, 271–72 (1988) (explaining the Supreme Court's unequivocal stand on the preemptive effect of the FAA upon conflicting state arbitration laws); Janet L. Herold, *Federal Preemption—Arbitration—Federal Arbitration Act Creates National Substantive Law Applicable in Federal and State Courts and Supersedes Contrary State Statutes*, 54 MISS. L.J. 571 (1984) (same); Hirshman, *supra* note 2 (same).

38. *Allied-Bruce Terminix Cos.*, 115 S. Ct. at 841. "The true significance of *Terminix*...is that it represents, in a practical sense, the last nail which once and for all seals the coffin containing the ancient corpus of law espousing deeply rooted hostility to arbitration contracts." Donald E. Johnson, *Has* Allied-Bruce Terminix Cos. v. Dobson *Exterminated Alabama's Anti-Arbitration Rule?*, 47 ALA. L. REV. 577, 578 (1996).

39. *Allied-Bruce Terminix Cos.*, 115 S. Ct. at 841.

40. *Southland Corp.*, 465 U.S. at 16; *Perry*, 482 U.S. at 492 n.9; *Allied-Bruce Terminix Cos.*, 115 S. Ct. at 839; *Doctor's Assocs., Inc.*, 116 S. Ct. at 1655–56.

41. Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987); Allied-Bruce Terminix Cos. v. Dobson, 115 S. Ct. 834, 843 (1995); Doctor's Assocs., Inc. v. Casarotto, 116 S. Ct. 1652, 1655–56 (1996).

invalidate such agreements.[42] All doubts as to whether a particular dispute is within the ambit of an arbitration clause must be resolved in favor of arbitration.[43] As a consequence of these Supreme Court edicts, state laws that attempt to limit the enforceability of arbitration agreements contained in contracts involving commerce are in large measure preempted by the provisions of the FAA.[44]

The Court has not, however, clearly resolved the issue of when a state's restrictive arbitration laws can be resurrected through insertion of a choice of law clause within the contract. Although the Court has declared that parties have the power to circumvent by agreement the provisions of the FAA, as will be discussed *infra*,[45] it has failed to clearly articulate the standard for determining whether and when the parties have so agreed. The difficulty in resolving this issue stems from the inherent ambiguity of a choice of law clause in the context of agreements to arbitrate.

There are three plausible interpretations that may be attributed to a choice of law clause and only one reflects an intent to bypass the preemptive effect of the FAA. First, the clause may be interpreted as a conflict of laws resolver, designating which among the fifty states' laws should govern, and leaving undisturbed the applicable federal law.[46] Second, it may be interpreted as an agreement to apply the designated state's substantive law, unencumbered by otherwise applicable federal law, but not encompassing the state's allocation of powers between courts and arbitrators, allowing the preemptive effect of the

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42. *Doctor's Assocs., Inc.*, 116 S. Ct. at 1655–56. "Courts may not...invalidate arbitration agreements under state law applicable only to arbitration provisions.... By enacting § 2 [of the FAA], we have several times said, Congress precluded states from singling out arbitration provisions for suspect status...." *Id.* at 1656.

43. First Options of Chicago, Inc. v. Kaplan, 115 S. Ct. 1920, 1924 (1995); Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc., 473 U.S. 614, 626 (1985); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24–25 (1983).

44. The extent to which contracts of employment are exempted from the protections of the FAA law has not been unequivocally resolved. Section 1 of the FAA excludes from the Act's coverage "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. § 1 (1994). Most federal courts have construed this exclusion narrowly, limiting its application to employees in transportation industries or actually engaged in the movement of goods in interstate commerce. *See, e.g.*, Rojas v. TK Communications, 87 F.3d 745, 748 (5th Cir. 1996); Central States Areas Pension Fund v. Central Cartage Co., 84 F.3d 988, 993 (7th Cir. 1996); Asplundh Tree Expert Co. v. Bates, 71 F.3d 592, 598 (6th Cir. 1995); Erving v. Virginia Squires Basketball Club, 468 F.2d 1064, 1069 (2d Cir. 1972); Dickstein v. DuPont, 443 F.2d 783, 785 (1st Cir. 1971); Tenney Eng'g v. United Elec. Radio & Mach. Workers, 207 F.2d 450, 452–53 (3d Cir. 1953). Only the Court of Appeals for the Fourth Circuit has construed the exclusion broadly to encompass all employees engaged in interstate commerce. United Elec. Radio & Mach. Workers v. Miller Metal Prods., Inc., 215 F.2d 221, 224 (4th Cir. 1954). The Supreme Court, however, has expressly declined to take a stand on this issue. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 25 n.2 (1991) (responding to an argument that the exclusion should be given a broad interpretation by stating: "[W]e leave for another day the issue raised...."). *See also* R. James Filiault, Comment, *Enforcing Mandatory Arbitration Clauses in Employment Contracts: A Common Sense Approach to the Federal Arbitration Act's Section 1 Exclusion*, 36 SANTA CLARA L. REV. 559, 577–85 (1996) (suggesting that § 1 should be given a narrow interpretation, limited to those engaged in interstate transportation).

45. *See infra* notes 72–75, 78–79, 134, 215–17 and accompanying text.

46. These three alternative interpretations to a choice of law clause were considered and discussed in Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212, 1217 (1995). *See infra* notes 136–37 and accompanying text.

FAA to remain intact.[47] Third, it may be interpreted as an agreement to apply the designated state's laws, including its arbitration laws, over all other state and federal laws, thereby excluding the FAA.[48]

As to which of these interpretations will be attributed to the parties depends upon whether a court must apply the designated state's rules of contract construction or whether the policies underlying the FAA mandate a rule of construction that preempts state law, and, if so, what that rule should be and when it should be imposed.

The United States Supreme Court has addressed this complicated issue in the case of *Volt Information Sciences, Inc. v. Board of Trustees*,[49] decided in 1989, and *Mastrobuono v. Shearson Lehman Hutton, Inc.*,[50] decided in 1995. An analysis of these cases, their application, and a proposed reconciliation follows.

II. *VOLT INFORMATION SCIENCES, INC. V. BOARD OF TRUSTEES*

In *Volt*, the parties had entered into a contract for the construction of electrical conduits on the Stanford campus, located in California.[51] The contract provided for resolution of all disputes through arbitration and further provided that "the contract shall be governed by the law of the place where the project is located."[52] Thereafter, a dispute arose regarding the compensation to which Volt was entitled for extra work undertaken in constructing the conduits.[53] In response to Volt's demand that the dispute be submitted to arbitration, Stanford filed in state court a civil action against Volt alleging fraud and breach of contract.[54] Stanford also joined two other companies involved in the construction project with whom Stanford did not have arbitration agreements, seeking indemnity against them in the event Volt prevailed.[55] Volt petitioned the trial court to compel arbitration of its dispute with Stanford.[56] The court denied the petition and instead stayed arbitration pending the outcome of Stanford's litigation with the joined defendants[57] as authorized by California Code of Civil Procedure section 1281.2.[58] The California Court of Appeals

47. *Mastrobuono*, 115 S. Ct. at 1217.
48. *Id.*
49. 489 U.S. 468 (1989).
50. 115 S. Ct. 1212 (1995).
51. 489 U.S. at 470.
52. *Id.*
53. *Id.*
54. *Id.* at 470–71.
55. *Id.* at 471.
56. *Id.*
57. *Id.*
58. That section provides, in pertinent part:

> If the court determines that a party to the arbitration is also a party to litigation in a pending court action or special proceeding with a third party..., the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action or special proceeding; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration among the parties who have agreed to arbitration and stay the pending court action or special proceeding pending the outcome of the arbitration proceedings; or (4) may stay arbitration pending the outcome of the court action or special proceeding.

CAL. CIV. PROC. CODE § 1281.2(c) (West 1982).

affirmed.[59] It acknowledged that the FAA governed the arbitration agreement and that the FAA does not authorize a stay of arbitration pending third party litigation.[60] Nevertheless, it held that the trial court properly ordered the stay because the parties had agreed to apply California's arbitration law and honoring that agreement was permitted by the FAA.[61] After the California Supreme Court denied review, Volt appealed to the United States Supreme Court.[62] It argued that the FAA requires all doubts as to whether a dispute is arbitrable to be resolved in favor of arbitration and because there was doubt as to whether the parties intended their choice of law clause to incorporate California's arbitration law, the clause must be construed to incorporate the FAA, thereby allowing arbitration to proceed.[63] Volt further argued that even if the parties had intended to apply California's arbitration law, the application of that law was nonetheless prohibited by the FAA.[64]

In an opinion written by Chief Justice Rehnquist,[65] the Supreme Court rejected those arguments and affirmed the court of appeal's decision,[66] finding no basis for departing from the general principle "that the interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review."[67] While agreeing that the FAA requires questions of arbitrability to be "addressed with a healthy regard for the policy favoring arbitration,"[68] and that "any doubts concerning the scope of arbitrable issues are to be resolved in favor of arbitration,"[69] it declared this principle not to be offended by construing a choice of law clause to exclude the FAA.[70]

> There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate. Interpreting a choice of law clause to make applicable state rules governing the conduct of arbitration...simply does not offend the rule of liberal construction set forth in *Moses H. Cone*, nor does it offend any other policy embodied in the FAA.[71]

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59. 489 U.S. at 471.
60. *Id.* at 471–72.
61. *Id.* at 472.
62. *Id.* at 472–73.
63. *Id.* at 475.
64. *Id.* at 476. Volt also contended that if the parties intended to be bound by California law, they were in effect waiving the protections of the FAA, whose validity must be judged by reference to federal rather than state law. *Id.* at 474.
65. *Id.* at 469. Chief Justice Rehnquist was joined by Justices White, Blackmun, Stevens, Scalia and Kennedy. *Id.* Justice Brennan filed a dissenting opinion, in which Justice Marshall joined. *Id.* at 479 (Brennan, J., dissenting). Justice O'Connor took no part in the consideration or decision of the case. *Id.*
66. *Id.*
67. *Id.* at 474.
68. *Id.* at 475 (quoting Brief for Appellant 92–96 (citing Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24–25 (1983))).
69. *Id.*
70. *Id.* at 476 (quoting Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc., 473 U.S. 614, 626 (1985)).
71. *Id.* The dissent took issue with this analysis:

> [I]nterpreting the parties' agreement to say that the California procedural rules apply rather than the FAA, where the parties arguably had no such intent, implicates the *Moses H. Cone* principle no less than would an interpretation of the parties' contract that erroneously denied the existence of an agreement to arbitrate.

Id. at 487.

The Court further found that applying a state's arbitration laws that would otherwise be preempted by the FAA was not prohibited when that application was pursuant to an agreement of the parties.[72] It accepted the proposition that state law will be preempted "to the extent that it actually conflicts with federal law—that is, to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[73] However, it found no such obstacle in honoring an agreement to bypass the preemptive effect of the FAA and to apply a state's rules of arbitration.[74] To hold otherwise, said the Court,

> would be quite inimical to the FAA's primary purpose of ensuring that private agreements to arbitrate are enforced according to their terms.... Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.[75]

The Court chose not to rule upon Volt's argument that even if the choice of law clause were construed to require application of the FAA, the stay of arbitration was nonetheless permissible as the sections of the FAA with which the stay allegedly conflicted, sections 3 and 4, are applicable only in federal court.[76] Because the choice of law clause was construed to require application of California's arbitration law, the Court found no need to take a position on that argument, other than to remark that it "is not without some merit."[77]

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72. *Id.* at 477–78.

73. *Id.* at 477 (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

74. *Id.* at 478–79.

75. *Id.* at 479. The Court also rejected Volt's argument that if the choice of law clause were construed to require application of California's arbitration law, it constituted a waiver of federal rights whose validity must be judged by reference to federal law. The FAA, said the Court, does not require that a dispute be arbitrated. It only requires disputes be arbitrated in the manner provided for in the parties' agreement. By incorporating California's arbitration rules, the contract created no right to compel arbitration of the dispute at issue and consequently there was no right to waive. *Id.* at 474–75.

76. Section 3 of the FAA provides:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration..., the court in which such suit is pending...shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement....

9 U.S.C. § 3 (1994).

Section 4 of the FAA provides:

> A party aggrieved by the alleged failure...of another to arbitrate...may petition any United States District court which, save for such agreement, would have jurisdiction...for an order directing that such arbitration proceed.... The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

Id. § 4.

77. 489 U.S. at 477. The Court elaborated upon that remark in footnote six of its opinion, stating that "[w]hile we have held that the FAA's 'substantive' provisions—§§ 1 and 2—are applicable in state as well as federal court...we have never held that §§ 3 and 4, which by their terms appear to apply only to proceedings in federal court...are nonetheless applicable in state court." *Id.* at 477 n.6 (citations omitted).

While it is true that the preemptive effect of §§ 3 and 4 has never been resolved, the Court appeared to be in error in suggesting that whether a state court's stay of arbitration is violative of the FAA depends upon resolution of that issue. The case of Dean Witter Reynolds,

A. Critique of Volt

The Court's decision that the parties may agree to apply a state's arbitration rules, where in the absence of such an agreement the FAA would preempt state law, is unassailable. The FAA was created to honor parties' arbitration agreements, not to disregard them.[78] If Volt and Stanford had expressly declared in their contract that they intended California's arbitration laws to apply, to the exclusion of all other laws, both state and federal, it would clearly have been proper to apply that state's rule permitting a stay of arbitration.[79]

It is the Court's decision to refuse to review the California Court of Appeal's conclusion that the parties intended by their ambiguously worded choice of law clause to exclude the FAA that is questionable. While stating that interpretation of a contract is ordinarily a matter of state law,[80] the Court conceded that federal arbitration laws may preempt state rules of contract interpretation.[81] It noted that doubts as to the scope of an arbitration clause must, by mandate of the FAA, be resolved in favor of an interpretation that

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Inc. v. Byrd, 470 U.S. 213 (1985), appears determinative. In that case, civil litigation involving two claims arising from the same transaction was commenced in federal court. *Id.* at 214. Pursuant to an agreement to arbitrate, one of the claims was subject to arbitration and the other was not. *Id.* at 215. Defendant filed a motion to compel arbitration of the arbitrable claim. The district court refused to compel arbitration, ordering both claims to be litigated. *Id.* at 216. Its stay of arbitration was consistent with a line of lower federal court decisions that assumed courts had discretion under the "doctrine of intertwining" to stay arbitration to prevent bifurcated proceedings because the purpose of the FAA was to promote speedy and efficient resolution of disputes and bifurcated proceedings promote neither speed nor efficiency. *Id.* at 217. The Supreme Court reversed. *Id.* at 224. The Court, while discussing §§ 3 and 4, refused to base its holding on those provisions, acknowledging that they did not expressly address this issue. *Id.* at 218–19. The Court instead referred to the legislative history of the FAA. *Id.* at 219. It concluded that the "preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation...." *Id.* at 221. For that reason, the district court's stay of arbitration violated the underlying purpose of the FAA, constituting reversible error. *Id.* at 224.

As *Byrd* was based, not on §§ 3 and 4, but on the purposes and objectives of Congress in enacting the FAA, and as *Volt* acknowledged that state law will be preempted to the extent that it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress, it would appear as if *Byrd* is as binding on state courts as it is on federal courts. If so, the stay of arbitration in *Volt*, in the absence of the choice of law clause as interpreted, would have been prohibited by the FAA. *See* Fairview Cemetery Ass'n v. Eckberg, 385 N.W.2d 812, 820–21 (Minn. 1986) (holding that *Southland* and *Byrd* precluded application of the doctrine of intertwining in a state court proceeding governed by the FAA). *See also* Zhaodong Jiang, *Federal Arbitration Right, Choice of law Clauses and State Rules and Procedure*, 22 SW. U. L. REV. 159, 203–04 (1992) (arguing that §§ 3 and 4 should apply to state courts and that based on *Byrd* and Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983), California's statutory authorization of a stay of arbitration pending litigation is preempted by the FAA).

78. Southland Corp. v. Keating, 465 U.S. 1, 13 (1984) (stating that "'the purpose of the act was to assure those who desired arbitration...that their expectations would not be undermined....'" (quoting Metro Indus. Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 387 (2d Cir. 1961))); Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404 n.12 (1967) (stating that "the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so").

79. The dissent in *Volt* did not disagree with the Court's holding that parties can bypass the FAA by agreement. It only disagreed with the majority's conclusion that the parties had so agreed. 489 U.S. at 481 n.4 (Brennan, J., dissenting).

80. *Id.* at 474.

81. *Id.* at 475–76.

would encompass the dispute in issue.[82] Its decision to uphold the California Court of Appeal's interpretation of the contract, therefore, depended upon its conclusion that, while the FAA's objectives would be undermined by construing an ambiguously worded arbitration clause in a manner that would prevent arbitration, those objectives would not be undermined by construing an ambiguously worded choice of law clause in a manner that would delay arbitration indefinitely.[83]

By upholding an interpretation of the choice of law clause to exclude the FAA, the Court upheld a stay of arbitration pending litigation of related claims that left Volt with few options. It could wait, perhaps for years, for the litigation to be concluded and then proceed with arbitration; it could opt to waive its right to arbitrate and resolve the dispute through litigation;[84] or it could decide that neither the option of delayed arbitration nor protracted litigation was a viable alternative and choose to settle or drop its claim despite believing in the merits of its case. No matter what Volt decided, the effect would not be significantly dissimilar from a judicial decision to prevent arbitration by interpreting an ambiguously worded arbitration agreement to not encompass the dispute in issue—a result the Supreme Court acknowledged would have been impermissible.[85]

The language of the decision created its own ambiguity. By stating that "[t]here is no federal policy favoring arbitration under a certain set of procedural rules,"[86] the Court may have been suggesting, or at least leaving open the possibility, that it might have decided otherwise if the state's rules affected matters of substance rather than procedure.[87] If the Court intended that implication, it left undecided how it would differentiate between substance and procedure and how it would evaluate a choice of law clause if the selection of the designated state's law involved the former.[88]

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82. *Id.* at 475.

83. *Id.* at 476.

84. Volt may have been denied the option of litigating its dispute if Stanford had insisted upon ultimate resolution through arbitration. In California, waiver of the right to arbitrate requires either an unreasonable delay in seeking arbitration, Spear v. California State Auto. Ass'n, 831 P.2d 821, 826 (Cal. 1992), or conduct that is inconsistent with an intent to arbitrate. Engala v. Permanente Med. Group, Inc., 43 Cal. Rptr. 2d 621, 643 (Ct. App. 1995).

Stanford did not unreasonably delay in seeking arbitration. It promptly and reasonably requested and was granted a stay of arbitration pending litigation. Seeking a delay of arbitration is not inconsistent with an intent to ultimately resolve the dispute through that process.

85. "[I]n applying general state-law principles of contract interpretation to the interpretation of an arbitration agreement within the scope of the Act...due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration." 489 U.S. at 475–76 (citation omitted).

86. *Id.* at 476.

87. *See* Marilyn B. Cane, *Punitive Damages in Securities Arbitration: The Interplay of State and Federal Law (or a Smaller Bite of the Big Apple)*, 1993 J. DISP. RESOL. 153, 157 (1993) (suggesting that courts may interpret *Volt* as being limited to procedural rules or as extending to substantive rules); Kenneth R. Davis, *Protected Right or Sacred Rite: The Paradox of Federal Arbitration Policy*, 45 DEPAUL L. REV. 65, 91 (1995) (stating that *Volt* suggests it was distinguishing between procedural and substantive rules); Faith A. Kaminsky, *Arbitration Law: Choice of law Clauses and the Power Between State and Federal Law*, 1991 ANN. SURV. AM. L. 527, 549 (1992) (stating that *Volt* may have intended its impact to govern only rules that are procedural in nature).

88. "Although *Volt* set forth a definitive approach in evaluating the preemptability of state procedural provisions in arbitration, no such clarity exists regarding a state substantive provision." Joseph P. Lakatos & Thomas G. Stenson, Note, *Punitive Damages Under the*

B. Judicial Implementation and Interpretation of Volt *Within the Choice of Law Context*

Courts have taken four separate approaches in evaluating the impact of *Volt* upon choice of law clauses in the context of agreements to arbitrate. The majority of courts, both state[89] and federal,[90] have summarily interpreted such clauses to encompass the designated state's arbitration laws irrespective of their impact upon the arbitration process. In these cases, courts declare without analysis or explanation other than a reference citation to *Volt* that because the parties intended the state's arbitration laws to apply, the preemptive effect of the FAA is negated.[91]

The second approach holds that *Volt* merely permits, but does not compel, the courts to construe a choice of law clause as encompassing the designated state's arbitration law. If the parties in fact intended federal arbitration law to apply, then, despite the parties choice of law clause, state law in conflict with the FAA is preempted.[92]

Federal Arbitration Act: Have Arbitrators' Remedial Powers Been Circumscribed by State Law?, 7 ST. JOHN'S J. LEGAL COMMENTARY 661, 672 (1992).

89. *See* Pacific Gas & Elec. Co. v. Superior Ct., 19 Cal. Rptr. 2d 295, 303 n.3 (Ct. App. 1993) (construing clause to require application of California's arbitration law in determining the standard of review of arbitration award); Henry v. Alcove Inv., Inc., 284 Cal. Rptr. 255, 259 (Ct. App. 1991) (construing clause to require application of California's arbitration law, authorizing stay of arbitration pending litigation of related claims); North Augusta Assocs. Ltd. Partnership v. 1815 Exch., Inc., 469 S.E.2d 759, 762 (Ga. Ct. App. 1996) (construing clause to require application of Georgia's arbitration law, under which court, rather than arbitrator, determines whether conditions precedent to arbitration have been satisfied); Tim Huey Corp. v. Global Boiler & Mechanical, Inc., 649 N.E.2d 1358, 1362 (Ill. App. Ct. 1995) (construing clause to require application of Illinois' arbitration law in determining the standard of review of arbitration award); Yates v. Doctor's Assocs., Inc., 549 N.E.2d 1010, 1015 (Ill. App. Ct. 1990) (construing clause to require application of Illinois' arbitration law in determining whether right to arbitrate had been waived); Albright v. Edward D. Jones & Co., 571 N.E.2d 1329, 1332–33 (Ind. Ct. App. 1991) (construing clause to require application of Indiana's arbitration law; invalidating agreement for failure to comply with statutory form requirements); Thomson McKinnon Sec., Inc. v. Cucchiella, 594 N.E.2d 870, 874 (Mass. App. Ct. 1992) (construing clause to require application of New York's arbitration law prohibiting an arbitrator from awarding punitive damages); Smith Barney, Harris Upham & Co. v. Luckie, 647 N.E.2d 1308, 1310 (N.Y. 1995) (construing clause to require application of New York's arbitration law under which court, rather than arbitrator, determines if limitations period for commencing arbitration has expired).

90. *See* Ekstrom v. Value Health, Inc., 68 F.3d 1391, 1395–96 (D.C. Cir. 1995) (construing clause to require application of Connecticut's arbitration law providing a 30-day statute of limitations for vacating arbitration awards); Barbier v. Shearson Lehman Hutton, Inc., 948 F.2d 117, 122 (2d Cir. 1991) (construing clause to require application of New York's arbitration law prohibiting an arbitrator from awarding punitive damages); Jeppsen v. Piper, Jaffray & Hopwood, Inc., 879 F. Supp. 1130, 1135 (D. Utah 1995) (construing clause to require application of Minnesota's arbitration law regarding timeliness of motion to vacate arbitration award); Rhodes v. Consumers' Buyline, Inc., 868 F. Supp. 368, 373 (D. Mass. 1993) (construing clause to require application of New York's arbitration law, invalidating agreement to arbitrate); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Jana, 835 F. Supp. 406, 413 (N.D. Ill. 1993) (construing clause to require application of New York's arbitration law prohibiting an arbitrator from awarding punitive damages); Melun Indus., Inc. v. Strange, 898 F. Supp. 995, 999 (S.D.N.Y. 1992) (construing clause to require application of New York's arbitration law prohibiting arbitrator from modifying award); Armco Steel Co. v. CSX Corp., 790 F. Supp. 311, 318 (D.D.C. 1991) (construing clause to require application of Ohio's arbitration law prohibiting arbitration of a dispute within a contract judicially declared invalid).

91. *See supra* notes 89–90.

92. *See* Conroy v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 899 F. Supp. 1471, 1474–75 (W.D.N.C. 1995); (construing clause to require application of FAA, rather than New

The third approach limits *Volt* to situations in which state rules of arbitration procedure are implicated. When application of state law would prevent arbitration of the particular dispute, that law is deemed substantive, rather than procedural, and in such a case an ambiguous choice of law clause must be construed to incorporate the preemptive provisions of the FAA.[93]

The fourth approach also assumes that *Volt* is not applicable if the designated state's arbitration law would prevent arbitration of the dispute. In that situation, the FAA necessarily governs and state law in conflict is preempted irrespective of whether the parties intended otherwise. Under this approach, the parties are not permitted to bypass the substantive provisions of the FAA.[94]

Of the four approaches, only the first is clearly in error to the extent it regards *Volt* as mandating an application of the designated state's arbitration laws. *Volt* held that the interpretation of private contracts is ordinarily a matter

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York's arbitration law, thereby allowing arbitrator to determine whether proceeding was time-barred); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shaddock, 822 F. Supp. 125, 134 (S.D.N.Y. 1993) (same); Marschel v. Dean Witter Reynolds, Inc., 609 So. 2d 718, 720–21 (Fla. Dist. Ct. App. 1992) (same); Primerica Fin. Servs., Inc. v. Wise, 456 S.E.2d 631, 633–35 (Ga. Ct. App. 1995) (construing clause to require application of FAA, rather than Georgia's arbitration law, thereby allowing parties to provide for expanded judicial review of arbitrator's award and upholding validity of agreement despite its prohibition under Georgia law).

93. *See* Remy Amerique, Inc. v. Touzet Distribution, 816 F. Supp. 213, 217–18 (S.D.N.Y. 1993) (stating that ambiguous choice of law clause must be construed to incorporate provisions of the FAA in determining whether a dispute is arbitrable); Osteen v. T.E. Cuttino Constr. Co., 434 S.E.2d 281, 284 (S.C. 1993) (stating that ambiguous choice of law clause must be construed to incorporate provisions of the FAA when the effect of state law would invalidate arbitration agreement).

94. *See* Ackerberg v. Johnson, 892 F.2d 1328, 1334 (8th Cir. 1989) (holding that despite choice of law clause designating Minnesota law, that law may not be applied to prevent arbitration of a dispute that is arbitrable under the FAA); Raytheon Co. v. Automated Bus. Sys., Inc., 882 F.2d 6, 11 n.5 (1st Cir. 1989) (holding that despite choice of law clause designating California law, that law may not be applied to deny the arbitrator the power to award punitive damages when that power exists under the FAA); Seymour v. Gloria Jean's Coffee Bean Franchising Corp., 732 F. Supp. 988, 995 (D. Minn. 1990) (holding that despite choice of law clause designating Minnesota law, that law may not be applied to invalidate an arbitration agreement that is valid under the FAA); Kelly v. Benchmark Homes, Inc., 550 N.W.2d 640, 643–44 (Neb. 1996) (holding that despite choice of law clause designating Nebraska law, that law may not be applied to invalidate an arbitration agreement that is valid under the FAA).

Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991) appeared to have adopted both the second and the fourth approaches. The issue before the court was whether a choice of law clause designating New York law precluded the award of punitive damages in an arbitration proceeding. *Id.* at 1061. In response to an argument that the award was invalid because New York arbitration law prohibits such relief, the court, applying the second approach, stated:

> The Supreme Court did not say a state choice of law provision that does not expressly encompass state arbitration rules, does so by operation of law. The Court merely said that it would not disturb a state court's factual determination that the parties to the contract in *Volt* intended to invoke California arbitration rules.

Id. at 1062. In declaring the award valid, the court appeared to apply the fourth approach, stating:

> In this case it is clear that federal rules, rather than New York state rules, apply. The Supreme Court has said time and again that issues of arbitrability in cases subject to the Act are governed by federal law. The Supreme Court did not reconsider these cases in *Volt* and the rule that federal law governs applies in this case.

Id.

of state law and that there was no basis, under federal law, to depart from that principle.[95] Rather than require a particular interpretation, the Court deferred to the California appellate court's interpretation of the clause to exclude the FAA.[96] In resolving a clause's meaning, therefore, an independent determination must be made as to whether, under state rules of contract interpretation, the parties in fact intended to exclude or include the provisions of the FAA.

Because of *Volt*'s inchoate suggestion that procedural rules are to be distinguished from non-procedural rules,[97] neither the third nor the fourth approach is clearly inconsistent with the Court's holding. The fourth approach, however, is inconsistent with the Court's reasoning. The opinion stressed that the FAA requires agreements to arbitrate, like other contracts, to be enforced according to their terms.[98] That effect is not achieved if, despite the parties' intent to apply a state's arbitration law to the exclusion of the FAA, their intent is disregarded.

C. Application of Volt *Beyond the Choice of Law Clause Context*

In *Casarotto v. Lombardi*,[99] the Montana Supreme Court concluded that *Volt* had preemptive relevance beyond the choice of law clause context, ameliorating the harsh effect of earlier Supreme Court decisions upon state arbitration laws. The court refused to enforce an arbitration agreement within a contract that involved commerce because that agreement was not written on the first page of the contract as required by Montana's arbitration law.[100] The contract contained no provision stating that Montana law shall apply[101] and the court assumed that the contract was governed by the FAA.[102] It ruled, however, that *Volt* had modified earlier Supreme Court decisions, including *Southland Corp. v. Keating*,[103] prohibiting states from enacting restrictive arbitration specific laws.[104] It construed *Volt*'s declaration that a state's arbitration law is preempted to the extent that it stands as an obstacle to the execution of Congress' full purposes and objectives to now permit states to exercise constraints upon arbitration beyond those contained in the FAA as long as those constraints do not undermine the policies of the FAA.[105] The court concluded that a notice requirement, imposed in order to assure that parties have knowingly waived their right to a court trial,[106] did not constitute a threat to the policies of the FAA and was therefore valid.[107]

The United States Supreme Court vacated the judgment and remanded the

95. *See supra* note 67 and accompanying text.
96. *See supra* notes 67, 71 and accompanying text.
97. *See supra* notes 86–88 and accompanying text.
98. *See supra* note 75 and accompanying text.
99. 886 P.2d 931 (Mont. 1994), *vacated sub. nom.* Doctor's Assocs., Inc. v. Casarotto, 115 S. Ct. 2552 (1995) (mem.).
100. *Id.* at 939.
101. The contract contained a choice of law clause designating Connecticut as the governing state. *Id.* at 933. However, the court held the choice of law clause was invalid as it violated Montana's public policy. *Id.* at 936.
102. *Id.* at 936.
103. *See supra* notes 37, 40 and accompanying text.
104. 886 P.2d at 937–38.
105. *Id.*
106. *Id.* at 935.
107. *Id.* at 939.

matter for further consideration[108] in light of its decision in *Allied–Bruce Terminix Cos. v. Dobson*,[109] which had refused to overturn *Southland Corp. v. Keating*,[110] stating that "[n]othing significant has changed in the 10 years subsequent to *Southland*; no later cases have eroded *Southland*'s authority ...."[111] The Montana Supreme Court reconsidered and reaffirmed its decision,[112] finding nothing in *Allied–Bruce* which necessitated a modification of its prior holding.[113] Once again the matter proceeded to the United States Supreme Court. This time the Court, in *Doctor's Associates, Inc. v. Casarotto*,[114] unequivocally reversed the decision.[115] In an opinion written by Justice Ginsburg,[116] the Court stated:

> The Montana Supreme Court misread our *Volt* decision.... We held that applying the state rule would not "undermine the goals and policies of the FAA" because the very purpose of the Act was to "ensur[e] that private agreements to arbitrate are enforced according to their terms." Applying [Montana's arbitration statute] would not enforce the arbitration clause in the contract....; instead, Montana's first-page notice requirement would invalidate the clause.... The state's prescription is thus inconsonant with, and is therefore preempted by, the federal law.[117]

Doctor's Associates clarifies any ambiguities as to the relevance of *Volt* beyond the choice of law context. *Volt* does not signify a retreat from the strict limitations upon states' ability to apply laws that deviate from the requirements of the FAA.

III. *MASTROBUONO V. SHEARSON LEHMAN HUTTON, INC.*

In *Mastrobuono*,[118] petitioners, unsophisticated investors, opened a securities trading account in 1985 with Shearson Lehman Hutton, Inc. (Shearson).[119] Their contract contained an arbitration agreement providing for arbitration in accordance with the arbitration code of the National Association of Securities Dealers (NASD).[120] It also included a choice of law clause by which the parties agreed that the contract was governed by New York law.[121] In 1989, petitioners filed a civil action in federal court against Shearson and some of its employees alleging that respondents, in violation of state and federal laws, had mishandled petitioners' account.[122] Respondents filed a motion to stay the court proceedings and to compel arbitration.[123] That motion was granted by

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108. Doctor's Assocs., Inc. v. Casarotto, 115 S. Ct. 2552 (1995) (mem.).
109. 115 S. Ct. 834 (1995).
110. 465 U.S. 1 (1984). *See supra* text accompanying notes 37, 40.
111. 115 S. Ct. at 839.
112. Casarotto v. Lombardi, 901 P.2d 596, 597 (Mont. 1995).
113. *Id.* at 598.
114. 116 S. Ct. 1652 (1996).
115. *Id.* at 1657.
116. *Id.* at 1654.
117. *Id.* at 1656–57 (citations omitted).
118. Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212 (1995).
119. *Id.* at 1214.
120. *Id.* at 1214, 1217.
121. *Id.* at 1214.
122. *Id.*
123. *Id.* at 1214–15.

the federal district court.[124] Arbitrators were appointed[125] and, after hearings, the panel ruled in favor of petitioners, awarding compensatory damages of $159,327 and punitive damages of $400,000.[126] Respondents paid the compensatory damages but filed a motion in district court to vacate the award of punitive damages,[127] contending that by their choice of law clause, the parties intended to apply the arbitration laws of New York which prohibit an arbitrator from awarding punitive damages.[128] The district court agreed and granted respondents' motion.[129] The Court of Appeals for the Seventh Circuit affirmed.[130] Petitioners then filed a petition for writ of certiorari with the United States Supreme Court, which was granted.[131]

In an opinion written by Justice Stevens,[132] the Court reversed the lower court decisions and reinstated the punitive damages award.[133] While acknowledging that parties have the power to contractually agree to bypass the protective provisions of the FAA,[134] the Court rejected the lower courts' determination that the parties in this case had so agreed.[135]

The Court referred to the ambiguity as to the intended meaning of the choice of law clause, noting the three interpretations that could reasonably be attributed to it.[136] Of the three, the Court noted that only the most sweeping—an intent to apply New York's laws, including its arbitration laws over all other laws, both state and federal—would reflect an intent to bypass the provisions of the FAA.[137] Because the intended scope of the choice of law clause was ambiguous, said the Court, it should have been construed to incorporate the FAA, which does not prevent arbitrators from awarding punitive damages.[138] The Court referred to three distinct legal principles to justify that holding.

First, citing *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*,[139] the Court referred to an interpretive principle underlying the FAA:

> At most the choice of law clause introduces an ambiguity into an arbitration agreement.... As we pointed out in *Volt*, when a court interprets such provisions in an agreement covered by the FAA, "due regard must be given to the federal policy favoring arbitration, and

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124. *Id.* at 1215.

125. *Id.* Pursuant to NASD arbitration rules, a panel of three arbitrators was convened. *Id.* NATIONAL ASS'N OF SECURITIES DEALERS, CODE OF ARBITRATION PROCEDURE § 19(a) (1985) [hereinafter ARBITRATION CODE].

126. 115 S. Ct. at 1215.

127. *Id.*

128. *Id.* In Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793, 794 (N.Y. 1976), the New York Court of Appeals held that only a court had the authority to award punitive damages and that to convey that power to an arbitrator would violate public policy.

129. 115 S. Ct. at 1215.

130. *Id.*

131. *Id.*

132. *Id.* at 1214. Chief Justice Rehnquist and Justices O'Connor, Scalia, Kennedy, Souter, Ginsburg and Breyer joined. Justice Thomas voiced the sole dissenting opinion.

133. *Id.* at 1219.

134. Citing *Volt*, the Court confirmed that "parties are generally free to structure their arbitration agreements as they see fit.... Thus, the case before us comes down to what the contract has to say about the arbitrability of petitioners' claim for punitive damages." *Id.* at 1216.

135. *Id.* at 1219.

136. *Id.* at 1217. *See supra* notes 46–48 and accompanying text.

137. *Id.*

138. *Id.* at 1219.

139. 460 U.S. 1, 24–25 (1983).

> ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration."[140]

Second, it stated that "respondents cannot overcome the common-law rule of contract interpretation that a court should construe ambiguous language against the interest of the party that drafted it.... Respondents drafted an ambiguous document, and they cannot now claim the benefit of the doubt."[141]

Third, the Court referred to the "cardinal principle of contract construction: that a document should be read to give effect to all its provisions and to render them consistent with each other."[142] The Court stated that the arbitration rules of the NASD authorized the award of "damages and other relief,"[143] and thereby authorized punitive damages.[144] If the choice of law clause were construed to require application of New York's arbitration law, punitive damages could not be awarded. That construction would contravene the parties' agreement to apply NASD rules of arbitration allowing expansive relief.[145] Only by interpreting the choice of law clause to include New York's substantive law "but not to include special rules limiting the authority of arbitrators" could the provisions of the contract be harmonized.[146]

> Thus the choice of law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other. In contrast, respondents' reading sets up two clauses in conflict with one another: one foreclosing punitive damages, the other allowing them. This interpretation is untenable.[147]

Mastrobuono stands in stark contrast and apparent conflict with *Volt*, which imposed no designated constraints upon a court's ability to construe a choice of law clause so as to circumvent the provisions of the FAA. Yet none of *Mastrobuono*'s proffered justifications address or attempt to reconcile that conflict.[148] The Court relegated its reconciliation efforts to a footnote, with the following statement:

> In *Volt*...we did not interpret the contract *de novo*. Instead, we deferred to the California court's construction of its own state law. In the present case, by contrast, we review a *federal* court's interpretation of this contract, and our interpretation accords with that of the only decision-maker arguably entitled to deference—the arbitrator.[149]

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140. 115 S. Ct. at 1218.

141. *Id.* at 1219 (citations omitted). The Court added that the reason for the rule is to protect the party who did not draft the contract "from an unintended or unfair result. That rationale is well-suited to the facts of this case. As a practical matter, it seems unlikely that petitioners were actually aware of New York's bifurcated approach to punitive damages, or that...they might be giving up an important substantive right." *Id.* (footnote omitted).

142. *Id.*

143. *Id.* at 1218.

144. "While not a clear authorization of punitive damages, this provision appears broad enough at least to contemplate such a remedy." *Id.*

145. *Id.* at 1219.

146. *Id.*

147. *Id.*

148. Although Justice O'Connor did not participate in *Volt*, *supra* note 65, and Justices Souter, Ginsburg and Breyer were not yet Supreme Court Justices, the shift in analysis within the two cases cannot be explained by a shift in Justices on the bench. The two dissenters in *Volt*, Justices Brennan and Marshall, had retired when *Mastrobuono* was decided, and Justices Rehnquist, Scalia, Kennedy and Stevens sided with the majority in both cases. *See supra* notes 65 and 132.

149. 115 S. Ct. at 1217 n.4 (citation omitted).

A. Critique of Mastrobuono

1. The Proffered Rationale

The Court's attempt to justify its decision upon the three stated legal principles is not persuasive. By stating that the choice of law clause created an ambiguity as to whether the parties intended to arbitrate the issue of punitive damages,[150] the Court succeeded in transferring the ambiguity from the clause to the arbitration agreement. That in turn allowed it to apply the first stated principle, that doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, resulting in the choice of law clause being construed to incorporate the provisions of the FAA which authorize arbitrators to award punitive damages.[151] The same shifting of ambiguities, however, could have been performed with equal ease in *Volt*. The ambiguous choice of law clause created an ambiguity as to whether the parties intended the particular dispute to be arbitrated or stayed pending litigation of non-arbitrable claims. That ambiguity would have to be resolved in favor of arbitration, resulting in the choice of law clause being construed to incorporate the provisions of the FAA, which would have required arbitration without delay.

Despite *Mastrobuono*'s citation of *Volt* as authority for the relevance of the stated principle to interpretation of an ambiguous choice of law clause,[152] the fact is that *Volt* expressly held that this principle is neither relevant nor offended by interpreting the clause to stay, rather than compel, arbitration. "Interpreting a choice of law clause to make applicable state rules governing the conduct of arbitration...simply does not offend the rule of liberal construction set forth in *Moses H. Cone*, nor does it offend any other policy embodied in the FAA."[153] The Court failed to explain why a principle that was regarded as immaterial in *Volt* became material in *Mastrobuono*.

The second principle, that ambiguities concerning the meaning of a contractual provision should be resolved against the drafter, while a generally accepted doctrine of contract law,[154] is in conflict with the Court's first stated principle. Frequently, if not usually, the one who drafted a contract so as to assure that future disputes between the parties would be arbitrated is the one who seeks to compel arbitration of disputes that thereafter arise.[155] In that

150. *See supra* note 140 and accompanying text.
151. *See supra* note 140 and accompanying text.
152. 115 S. Ct. at 1218.
153. 489 U.S. at 476.
154. *See* Wilbur v. Toyota Motor Sales, U.S.A., Inc. 86 F.3d 23, 27 (2d Cir. 1996); United States Abatement Corp. v. Mobil Exploration & Producing U.S., Inc., 79 F.3d 393, 400 (5th Cir. 1996); Estate of Parker v. Dorchak, 673 So. 2d 1379, 1381–82 (Miss. 1996); Jacobs v. Georgiou, 922 S.W.2d 765, 771 (Mo. Ct. App. 1996); 196 Owners Corp. v. Hampton Management Co., 642 N.Y.S.2d 316, 317 (App. Div. 1996); Mountain View/Evergreen Improvement & Serv. Dist. v. Casper Concrete Co., 912 P.2d 529, 532 (Wyo. 1996); RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981); Ollivette E. Mencer, *Unclear Consequences: The Ambient Ambiguity*, 22 S.U. L. REV. 217, 223 (1995); Jayne Elizabeth Zanglein, *Closing the Gap: Safeguarding Participants' Rights by Expanding the Federal Common Law of ERISA*, 72 WASH. U. L.Q. 671, 692 (1994).
155. For example, the United States Supreme Court decisions explaining and expanding the purview of the FAA have usually involved situations in which arbitration was compelled in favor of the party who drafted the agreement. *See* Doctor's Assocs., Inc. v. Casarotto, 116 S. Ct. 1652, 1654 (1996) (requiring franchisee, who signed standard form contract to arbitrate disputes with franchisor, to arbitrate despite agreement's invalidity under state law); Allied–

event, because doubts as to whether a particular dispute was within the ambit of the arbitration agreement will be resolved in favor of arbitration, those doubts will also be resolved in favor of the party who drafted the contract.[156] In such cases, the general principle that doubts will be resolved against the drafter is disregarded.[157]

Occasionally, the party who drafted the contract to provide for arbitration will thereafter seek to restrict the arbitrator's authority. *Mastrobuono* involved such a situation.[158] As a result, the Court's enunciated

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Bruce Terminix Cos., Inc. v. Dobson, 115 S. Ct. 834, 837 (1995) (requiring home owner, who signed form contract to arbitrate disputes with termite inspector, to arbitrate despite agreement's invalidity under state law as the contract involved commerce); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 23 (1991) (requiring employee, who signed standard form contract to arbitrate disputes with employer, to arbitrate claims arising under the Federal Age Discrimination in Employment Act); Rodriguez De Quijas v. Shearson/American Express, Inc., 490 U.S. 477, 477 (1989) (requiring investors, who signed form contract to arbitrate disputes with broker, to arbitrate claims arising under 1933 Securities Exchange Act); Perry v. Thomas, 482 U.S. 483, 485 (1987) (requiring employee, who signed form contract to arbitrate disputes with employer, to arbitrate wage claims despite state statute prohibiting arbitration of such claims); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 223 (1987) (requiring investors, who signed form contract to arbitrate disputes with broker, to arbitrate claims arising under 1934 Securities Exchange Act); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 215 (1985) (requiring investor, who signed form contract to arbitrate disputes with broker, to arbitrate those claims which were arbitrable); Southland Corp. v. Keating, 465 U.S. 1 (1984), *rev'g* Keating v. Superior Ct., 31 Cal.3d 584 (1982) (requiring franchisee, who signed form contract to arbitrate disputes with franchisor, to arbitrate despite agreement's invalidity under state law).

156. Almost without exception, courts have resolved doubts in favor of arbitration despite the fact that the drafting party was the one seeking the expansive interpretation. *See, e.g.,* Rojas v. TK Communications, Inc., 87 F.3d 745, 749 (5th Cir. 1996) (arbitration agreement interpreted to encompass employee's Title VII sex discrimination claim); Golenia v. Bob Barker Toyota, 915 F. Supp. 201, 204, 205 (1996) (arbitration agreement interpreted to encompass employee's Americans with Disabilities Act claim); Pritzker v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 7 F.3d 1110, 1114–15, 1118 (1993) (arbitration agreement interpreted to encompass employee's ERISA claim); Thomas v. Prudential Sec., Inc., 921 S.W.2d 847, 849, 851 (Tex. Ct. App. 1996) (arbitration agreement interpreted to encompass award of attorney's fees in favor of investment firm after arbitrators dismissed investors' claims that the firm had defrauded them). *Contra* Victoria v. Superior Ct., 40 Cal. 3d 734, 744 (1985) (arbitration agreement interpreted not to encompass tort claim against hospital when patient, signing adhesion type contract, was raped by hospital's employee while recuperating from brain surgery).

157. In Mitsubishi Motors Corp. v. Soler Chrysler–Plymouth, Inc., 473 U.S. 614 (1985), the Supreme Court considered whether a contractual agreement between a manufacturer and retailer of automobiles required the retailer to arbitrate federal and state statutory claims against the manufacturer. Applying the doctrine that doubts as to the scope of an arbitration agreement must be resolved in favor of arbitration, the Court held that the parties' agreement must be construed to encompass statutory claims. *Id.* at 628. The Court declared its intransigent stand upon the applicability of this principle irrespective of whether arbitration will be compelled against a party with little or no bargaining power in negotiating the contract's terms.

> Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds "for the revocation of any contract." But absent such compelling considerations, the Act itself provides no basis for disfavoring agreements to arbitrate statutory claims by skewing the otherwise hospitable inquiry into arbitrability.

Id. at 627 (citations omitted). *Mitsubishi* was cited by *Mastrobuono* in support of its opinion. 115 S. Ct. at 1218 n.7. *See also* Anne Brafford, Note, *Arbitration Clauses in Consumer Contracts of Adhesion: Fair Play or Trap for the Weak and Unwary?*, 21 J. CORP. L. 331, 339–42 (1996) (commenting on the Supreme Court's refusal to afford special legal protections to consumers who have signed adhesion contracts providing for arbitration and its insistence on having doubts in such contracts resolved in favor of arbitration).

158. 115 S. Ct. at 1214, 1215.

principle that ambiguities should be resolved against the drafter was consistent with the principle that ambiguities as to the scope of the arbitrator's powers should be resolved in favor of arbitration. Harmonious reconciliation of these two principles will, however, often be impossible.

For example, assume that the arbitrators had awarded petitioners compensatory damages and, while concluding that they had the power to award punitive damages, decided to deny that remedy on the merits. Petitioners might then have sought to vacate that portion of the award on the ground that the parties' choice of law clause required application of New York's arbitration law, thereby depriving the arbitrators of the power to grant or deny punitive damages and allowing petitioners to seek such relief in a court of law.[159] In order to foreclose that option to petitioners, respondents might contend that the choice of law clause should be construed to incorporate the provisions of the FAA, thereby allowing the award to stand. If ambiguities as to the meaning of the choice of law clause were resolved under the Court's first stated principle, respondents would prevail. If they were resolved under the second principle, petitioners would prevail.

Conflicts between these two principles can also arise in contexts other than those involving the arbitrator's remedial powers. Assume the party who drafted the contract seeks to compel arbitration of a dispute that under state law is not arbitrable because that state prohibits arbitration of the particular dispute;[160] the agreement lacks that state's formality requirements;[161] that state's courts construe arbitration agreements restrictively;[162] or, as in *Volt*, that state's courts will stay arbitration pending litigation of related claims.[163] If the choice of law clause is interpreted under the Court's first principle, ambiguities will be resolved in favor of arbitration, the FAA will apply, and the dispute will be arbitrated. If the clause is interpreted under the second principle, ambiguities will be resolved against the drafter, the FAA will not apply, and the dispute will not be arbitrated. In these situations, the Court has offered no indication of which of the two conflicting principles should be given priority.

The Court's third stated principle, that contract terms should be read to render them consistent with each other, while conceptually sound,[164] was misguided in application. The Court's conclusion that applying New York's

159. New York does not prevent the recovery of punitive damages when parties have agreed to submit their disputes to arbitration. It only precludes the arbitrator from awarding that remedy. Under New York law, a party remains free to seek damages in a separate judicial proceeding even if she initially sought their recovery in arbitration and the arbitrator expressly denied their recovery on the merits. *See* Mulder v. Donaldson, Lufkin & Jenrette, 623 N.Y.S.2d 560, 564–65 (App. Div. 1995); Belco Petroleum Corp. v. Aig Oil Rig, Inc., 565 N.Y.S.2d 776, 784–85 (App. Div. 1991). The Supreme Court's statement that the Mastrobuonos were "giving up an important substantive right" was, therefore, erroneous. *See supra* note 141.

160. *See supra* notes 12–17 and accompanying text.

161. *See supra* notes 18–21 and accompanying text.

162. *See supra* notes 23–28 and accompanying text.

163. *See supra* notes 22, 58 and accompanying text.

164. Clardy Mfg. Co. v. Marine Midland Business Loans, Inc., 88 F.3d 347, 352 (5th Cir. 1996); Buchanan v. Little Rock Sch. Dist., 84 F.3d 1035, 1039 (8th Cir. 1996); Slawson Exploration Co. v. Vintage Petroleum, Inc., 78 F.3d 1479, 1481 (10th Cir. 1996); Ryan v. Ryan, 659 N.E.2d 1088, 1092 (Ind. Ct. App. 1995); Mapletown Foods, Inc. v. Motorists Mut. Ins. Co., 662 N.E.2d 48, 49 (Ohio Ct. App. 1995); Austin Hardwoods, Inc. v. Berghe, 917 S.W.2d 320, 323 (Tex. Ct. App. 1995); RESTATEMENT (SECOND) OF CONTRACTS §§ 202(5), 203(a) (1981).

arbitration law would conflict with other terms of the contract was based upon an unwarranted and unnecessary interpretation of the NASD's Code of Arbitration Procedure, which the parties had incorporated into their agreement.[165] The Court regarded the Code's reference to "damages and other relief" as authorizing broad remedial powers to the arbitrators.[166] Taken in context, the provision in the Code from which the quoted phrase was lifted does not support the Court's conclusion:

> The award shall contain the names of the parties, the name of counsel, if any, a summary of the issues, including the type(s) of any security or product, in controversy, the damages and other relief requested, the damages and other relief awarded,...the location of the hearings, and the signatures of the arbitrators concurring in the award."[167]

This provision appears to designate the requisite structural format of the written award rather than attempt to designate the limits of arbitrators' powers.[168] It no more authorizes the arbitrators to select a remedy than it authorizes them to select the location of the hearings.

The Court could have chosen to interpret this provision, as it is literally written, to be silent on the arbitrators' remedial powers, thereby leaving the scope of those powers to be governed by other provisions of the contract and relevant law. If it had been so interpreted, there would have been no inconsistency in holding that the choice of law clause encompassed New York's arbitration law, prohibiting the award of punitive damages.

Furthermore, even if the Court was correct that the NASD's Code of Arbitration Procedure specifically authorizes arbitrators to grant broad remedial relief, incorporating New York arbitration law would not have been inconsistent with that authorization. When powers are granted under a contract, it is axiomatic that the contract impliedly limits the exercise of those powers in a manner that is lawful.[169] A contract authorizing arbitrators to award damages and other relief, therefore, impliedly limits such relief to that which is lawful. No contractual disharmony would arise if the choice of law clause were construed to require application of New York's arbitration law because the contractual provision authorizing the award of "damages and other relief" would exclude the ability to award punitive damages and such an award would, under New York law, be unlawful.

Presumably, if the contract had not incorporated the NASD Code of Arbitration Procedure and had merely provided for arbitration of disputes between the parties, there would have been no contractual disharmony in

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165. 115 S. Ct. at 1217.
166. *Id.* at 1218.
167. ARBITRATION CODE, *supra* note 125, § 41(e).
168. This was the position taken by Justice Thomas in his dissent. "It is clear that §41(e) does not define or limit the power of the arbitrators; it merely describes the form in which the arbitrators must announce their decision." 115 S. Ct. at 1221. *Accord* Baravati v. Josephthal Lyons & Ross, Inc. 28 F.3d 704, 710 (7th Cir. 1994) (stating that the NASD Code of Arbitration Procedure is silent as to the remedial powers of the arbitrators).
169. *See, e.g.*, Walsh v. Schlecht, 429 U.S. 401, 408 (1977); Fosson v. Palace (Waterland), Ltd., 78 F.3d 1448, 1454 (9th Cir. 1996); Transamerica Ins. Co. v. Avenell, 66 F.3d 715, 722 (5th Cir. 1995); McCabe/Marra Co. v. City of Dover, 652 N.E.2d 236, 246 (Ohio Ct. App. 1995); Crockett v. McKenzie, 867 P.2d 463, 465 (Okla. 1994); RESTATEMENT (SECOND) OF CONTRACTS § 203(a) (1981); George Lee Flint, *ERISA: Reformulating the Federal Common Law for Plan Interpretation*, 32 SAN DIEGO L. REV. 955, 1062 (1995).

applying New York's arbitration laws. The Court gave no indication how it would have ruled in that situation.

2. The Court's Attempted Reconciliation of Mastrobuono *with* Volt

The Court attempted to reconcile *Mastrobuono* with *Volt* by stating that in *Volt*, the Court properly deferred to a state court's interpretation of its own state law while in *Mastrobuono*, it was engaged in de novo review of a lower federal court's interpretation of the contract.[170]

This would suggest that *Mastrobuono* is applicable only when the choice of law clause's intended meaning is resolved in federal court. State courts would remain free to ignore *Mastrobuono* while federal courts would be obligated to honor it. When the Supreme Court held in *Southland Corp. v. Keating*[171] that the provisions of the FAA must be honored by state courts as well as federal courts, it did so to assure uniformity of law irrespective of the selected forum. To hold otherwise would "encourage and reward forum shopping. We are unwilling to attribute to Congress the intent...to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted."[172] That rationale was reasserted in *Allied–Bruce Terminix Cos. v. Dobson*,[173] which refused to overrule *Southland*.[174] If *Mastrobuono*'s holding is applicable only when the interpretation of the choice of law clause is before a federal court, the very forum shopping the Court has assiduously sought to avoid will be induced.

Furthermore, the Court's premise that a state court's interpretation of a choice of law clause is entitled to deference while a federal court's interpretation is subject to de novo review is insupportable. It is true, as the Court stated, that a contract's interpretation is ordinarily a question of state law[175] and that resolution of that issue by a state court is, therefore, not ordinarily subject to review by the Supreme Court.[176] However, a contract whose interpretation is governed by state law remains so governed despite the fact that its interpretation is made by a federal court.[177] The Supreme Court has repeatedly followed a standard of deference in reviewing lower federal courts' construction of state law and will only reverse that construction in the presence of plain error.[178] That deference "reflect[s] our belief that district courts and

170. 115 S. Ct. at 1217. *See supra* note 150 and accompanying text.
171. 465 U.S. 1 (1984).
172. *Id.* at 15.
173. 115 S. Ct. 834 (1995). "In *Southland v. Keating*, *supra*, this Court decided that Congress would not have wanted state and federal courts to reach different outcomes about the validity of arbitration in similar cases." *Id.* at 838.
174. *Id.* at 839.
175. Arkansas La. Gas Co. v. Hall, 453 U.S. 571, 579 n.9 (1981); Clardy Mfg. Co. v. Marine Midland Bus. Loans, Inc., 88 F.3d 347, 352 (5th Cir. 1996); Baker v. America's Mortgage Servicing, Inc., 58 F.3d 321, 326 (7th Cir. 1995); Beazer E., Inc., v. Mead Corp., 34 F.3d 206, 212 (3d Cir. 1994).
176. *See Arkansas La. Gas Co.*, 453 U.S. at 579 n.9 ("The state court found that the contract had been breached. We will not overturn the construction of Louisiana law by the highest court of that State.").
177. *See Clardy Mfg. Co.*, 88 F.3d at 352; *Baker*, 58 F.3d at 326; *Beazer E., Inc.*, 34 F.3d at 212.
178. *See* Planned Parenthood v. Casey, 505 U.S. 833, 880 (1992); Ohio v. Akron Ctr. for Reprod. Health, 497 U.S. 502, 514 (1990); Frisby v. Schultz, 487 U.S. 474, 482 (1988); Brockett v. Spokane Arcades, Inc., 472 U.S. 491, 500 (1985).

courts of appeals are better schooled in and more able to interpret the laws of their respective States."[179] The Supreme Court's decision to review the lower federal courts' interpretation of the choice of law clause on a de novo basis was in manifest disregard of that designated standard. Had it applied a standard of deference, it could not have reversed the decisions of the lower federal courts. The intended meaning of the choice of law clause was ambiguous. As the Court acknowledged, there were three reasonable interpretations that could be attributed to that clause.[180] The lower federal courts' decision to adopt one of those three reasonable interpretations, therefore, did not constitute plain error.

The Court's determination to engage in de novo review would be justified if its holding were based upon federal arbitration law rather than state contract law.[181] The Court's first stated principle, that all doubts as to the scope of an arbitration agreement are to be resolved in favor of arbitration, is, as *Mastrobuono* pointed out, a doctrine of federal arbitration law.[182] However, the FAA's requirement that doubts as to the scope of an arbitration clause must be resolved in favor of arbitration is as applicable in state court as it is in federal court.[183] *Volt* itself acknowledged the applicability of this principle in state court.[184] *Volt* circumvented the application of this principle, not because of the forum of the case, but because the Court refused to find that it had any relevance to the issue of whether the parties had by their choice of law clause intended to bypass the provisions of the FAA and to apply the designated state's arbitration laws instead.[185]

In holding that the first stated principle does have bearing upon resolving the issue of whether the parties intended their choice of law clause to bypass the provisions of the FAA,[186] *Mastrobuono* either was overruling *Volt* or was distinguishing *Volt*'s refusal to apply this principle on a basis that it failed to articulate.

The Court concluded its attempt to distinguish *Mastrobuono* from *Volt* with the cryptic comment "our interpretation accords with that of the only

179. *Casey*, 505 U.S. at 880 (quoting Frisby v. Schultz, 487 U.S. 474, 482 (1988)). *Accord Akron Ctr. for Reprod. Health*, 497 U.S. at 514; *Brockett*, 472 U.S. at 500.

180. *See supra* note 136 and accompanying text.

181. *See* Doctor's Assocs., Inc. v. Casarotto, 116 S. Ct. 1652, 1656 (1996) (overruling Montana Supreme Court's interpretation of *Volt*); Allied-Bruce Terminix Cos. v. Dobson, 115 S. Ct. 834, 841 (1995) (overruling Alabama Supreme Court's interpretation of whether contract involved commerce). *See also* Hernandez v. New York, 500 U.S. 352, 367 (1991) (distinguishing between state court determinations of fact, requiring deference, and state court determinations of federal law, requiring independent review); Harte-Hanks Communications, Inc. v. Connaughton, 491 U.S. 657, 686 (1989) (same).

182. "The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration...." 115 S. Ct. at 1218 n.8 (quoting Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S., 1, 24-25 (1983)).

183. "Federal law in terms of the Arbitration Act governs that issue [arbitrability] in either state or federal court." Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

184. "[I]n applying general state-law principles of contract interpretation to the interpretation of an arbitration agreement within the scope of the Act, due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration." 489 U.S. 468, 475-76 (1989) (citations omitted).

185. *Id.* at 476. *See supra* notes 68-71 and accompanying text.

186. *See supra* note 139 and accompanying text.

decision-maker arguably entitled to deference—the arbitrator."[187] That comment suggests that as the arbitrators had already determined they had the power to award punitive damages, their determination was entitled to evidentiary weight. In *Volt*, by contrast, the state court's determination that arbitration was to be stayed was made by a court prior to submission of the dispute to arbitration and did not require the court to ignore arbitrators' previous resolution of that issue.

A suggestion that this factual distinction between the cases justifies a differing standard of review is without merit. While courts will ordinarily not review arbitrators' conclusions of law or fact as to the merits of the parties' claims,[188] no deference is afforded to arbitrators' determination of the scope of their powers. The reviewing court will independently ascertain the extent of those powers and the arbitrators' conclusions on this subject have no weight.[189] This was the generally recognized rule prior to *Mastrobuono*[190] and it was confirmed by the Supreme Court two months after *Mastrobuono* in the case of *First Options of Chicago, Inc. v. Kaplan.*[191]

B. Judicial Implementation and Interpretation of Mastrobuono

To date federal courts, when forced to choose, have considered themselves obligated by *Mastrobuono* to interpret choice of law clauses so as to encompass the FAA.[192] No federal case, as yet, has expressly ruled upon any of the decision's unresolved issues, such as whether it governs situations in which not all of its justifying principles are applicable or in which one of the

187. *See supra* note 149 and accompanying text.

188. "The '[p]ower to vacate an award is limited,' and...'interpretations of the law by the arbitrators...are not subject, in the federal courts, to judicial review for errors in interpretation.'" Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 231 (1987), (quoting Wilko v. Swan, 346 U.S. 427, 436–37 (1953)). *See also* First Options of Chicago, Inc. v. Kaplan, 115 S. Ct. 1920, 1923 (1995) (A party can seek review of an arbitrator's decision, "but the court will set that decision aside only in very unusual circumstances.").

189. Arbitrators may decide their own power only when there is "clear and unmistakable" evidence that the parties conferred that power upon the arbitrators. First Options of Chicago, Inc. v. Kaplan, 115 S. Ct. 1920, 1924 (1995). "If, on the other hand, the parties did not agree to submit the arbitrability question itself to arbitration, then the court should decide that question just as it would decide any other question that the parties did not submit to arbitration, namely independently." *Id.*

190. *See* AT & T Techs., Inc. v. Communications Workers, 475 U.S. 643, 649 (1986); United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 583 n.7 (1960).

191. 115 S. Ct. at 1924. For a discussion of *First Options*, see Stephen L. Hayford, *Commercial Arbitration in the Supreme Court 1983–1995: A Sea Change*, 31 WAKE FOREST L. REV. 1, 32–33 (1996); Shirin Philipp, Note, *Is the Supreme Court Bucking the Trend?* First Options v. Kaplan *in Light of European Reform Initiatives in Arbitration Law*, 14 B.U. INT'L L.J. 119, 124–26 (1996).

192. *See* PaineWebber Inc. v. Elahi, 87 F.3d 589 (1st Cir. 1996); National Union Fire Ins. Co. v. Belco Petroleum Corp. 88 F.3d 129 (2d Cir. 1996); PaineWebber Inc. v. Bybyk, 81 F.3d 1193 (2d Cir. 1996); Davis v. Prudential Sec., Inc., 59 F.3d 1186 (11th Cir. 1995); Kelley v. Michaels, 59 F.3d 1050 (10th Cir. 1995). In Doctor's Assocs., Inc. v. Distajo, 66 F.3d 438 (2d Cir. 1995), the court, while stating that the choice of law clause required application of Connecticut law, *id.* at 451, appeared to be referring to Connecticut's substantive law and not its arbitration law, inasmuch as the court proceeded to evaluate the case by applying all relevant preemptive provisions of the FAA. *Id.* at 452–57. The Court's only reference to *Mastrobuono* concerned a separate issue—whether an arbitration agreement must be supported by independent consideration. The court concluded that independent consideration was not required, citing *Mastrobuono* for the proposition that in evaluating an arbitration clause, the entire contract must be considered. *Id.* at 452.

principles is in conflict with another, or whether a federal court ever has discretion to interpret a choice of law clause to exclude the FAA. One of those issues was raised, but not resolved, in *Lanier v. Old Republic Insurance Co.*,[193] where a United States District Court was asked to grant a motion to remand an arbitration award to the panel for clarification.[194] In evaluating its power to grant the motion, the court considered the impact of an Alabama choice of law clause upon governing law.[195] The parties' arguments focused on whether interpreting the clause to incorporate Alabama's law would conflict with the terms of the arbitration agreement and, if not, whether *Mastrobuono* was controlling.[196] The court saw no need to answer the latter question, finding the law of Alabama and the FAA to be in accord, with both allowing remand.[197] In passing, however, the court articulated the confusion that *Mastrobuono* has generated and will continue to generate: "This court will not undertake unnecessarily the difficult task of deciding whether the circumstances presented here fall within the holding of *Mastrobuono* (federal law controls) or that of *Volt* (state law controls). The court must admit the difference between the two cases, while there, is difficult to grasp."[198]

Federal courts have without discussion implicitly assumed that *Mastrobuono* extends to cases in which resolution of the choice of law question will determine whether a particular dispute should be submitted to arbitration as compared to whether a particular award should be confirmed.[199] For example, in *PaineWebber Inc. v. Elahi*,[200] the Second Circuit Court of Appeals affirmed a district court order compelling arbitration, holding that it was obligated under *Mastrobuono* to interpret the choice of law clause to incorporate the FAA when the issue concerned whether a party had exceeded the contractual time period for commencing arbitration.[201] Under New York law, that issue would have been resolved by the court.[202] Under the FAA it was a matter for the arbitrator to decide.[203]

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193. 936 F. Supp. 839 (M.D. Ala. 1996).
194. *Id.*
195. *Id.* at 843–44.
196. *Id.* at 844.
197. *Id.* at 847.
198. *Id.* at 844.
199. PaineWebber Inc. v. Elahi, 87 F.3d 589, 594 (1st Cir. 1996) (whether arbitration was precluded because not commenced within contractual limitations period was, under the FAA, for the arbitrator to decide); National Union Fire Ins. Co. v. Belco Petroleum Corp., 88 F.3d 129, 135 (2d Cir. 1996) (whether prior arbitration award had preclusive effect in subsequent arbitration proceeding was, under the FAA, for the arbitrator to decide); PaineWebber Inc. v. Bybyk, 81 F.3d 1193, 1200 (2d Cir. 1996) (whether arbitration was precluded because not commenced within contractual limitations period was, under the FAA, for arbitrator to decide).

In these cases, as in *Volt*, the determination of whether the arbitrator was empowered to hear the particular issue, which depended upon the choice of law clause's interpretation, was made prior to submission of the matter to arbitration. In *Mastrobuono*, the determination was made subsequent to the award and the Court noted that it was merely deferring to the arbitrators' determination of their own powers and regarded that fact as justification for its departure from *Volt*'s holding. 115 S. Ct. 1212, 1217 n.4 (1995). *See supra* notes 150, 188 and accompanying text. The courts in these cases did not address this distinction from *Mastrobuono* and similarity to *Volt*, but, by implication at least, rejected its relevance.
200. 87 F.3d 589 (1st Cir. 1996).
201. *Id.* at 593–94.
202. *Id.* at 592.
203. *Id.* at 601.

State courts have tended to give *Mastrobuono* a narrow reading. Some have ruled, contrary to federal courts, that they are free to apply the designated state's law in determining whether the agreement to arbitrate is enforceable.[204] In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ohnuma*,[205] for example, the issue was identical to that considered in *PaineWebber Inc. v. Elahi*.[206] The New York Supreme Court, Appellate Division, interpreted the choice of law clause to incorporate New York's arbitration law, requiring the timeliness issue to be judicially resolved.[207] The court concluded that the time period for commencing arbitration had been exceeded and permanently stayed arbitration of the dispute.[208] The relevance of *Mastrobuono* was considered and rejected. "*Mastrobuono* did not concern substantive arbitrability, and the Supreme Court's holding in that case does not alter the rule in this state" that whether a matter is time-barred is for the court and not the arbitrator.[209]

Two state courts concluded they were obligated to apply the FAA when the issue was essentially the same as that in *Mastrobuono*—whether a New York choice of law clause should be construed to restrict the arbitrators' ability to award punitive damages.[210] However, another court stated in dicta that *Mastrobuono*, even in that limited context, is not binding authority as its holding is applicable only to federal courts.[211] An unreported Connecticut case[212] expressly held that the decision is controlling only when a federal court is construing the choice of law clause and that *Volt* remains governing law when the issue is before a state court, concluding that this is "the only way to reconcile *Moses H. Cone, Volt,* and *Mastrobuono*."[213]

IV. RECONCILING *VOLT* WITH *MASTROBUONO*

Despite their apparent discord, these two Supreme Court cases are in agreement that parties have freedom under the FAA to apply a state's restrictive arbitration laws, even though those laws would be preempted by the FAA in the absence of such an agreement.

Mastrobuono quoted with approval *Volt*'s declaration that:

> Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will

204. *See* Prudential Sec., Inc. v. Pesce, 642 N.Y.S.2d 466, 467 (Sup. Ct. 1996); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ohnuma, 630 N.Y.S.2d 724, 726 (App. Div. 1995).

205. 630 N.Y.S.2d at 724.

206. *See supra* note 201 and accompanying text.

207. 630 N.Y.S.2d at 725.

208. *Id.* at 726.

209. *Id.*

210. Roubik v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 1–94–2774, 1996 WL 218654 at *2 (Ill. App. Ct. May 1, 1996); Prudential Sec., Inc. v. Pesce, 642 N.Y.S.2d 466, 468 (Sup. Ct. 1996).

211. Even if the instant case involved a standard-form contract with the identical New York choice of law clause, this court would not be bound to interpret it in the same manner as the U.S. Supreme Court did in *Mastrobuono*, since the interpretation of contracts is a matter of state law. *See Mastrobuono*, 115 S. Ct. 1212, 1217 n.4 (1995). Dean Witter Reynolds, Inc. v. Trimble, 631 N.Y.S.2d 215, 217 n.4 (Sup. Ct. 1995).

212. Levine v. Advest, Inc., No. CV 940541857S, 1996 WL 57084, at *7 (Conn. Super. Ct. Jan. 11, 1996).

213. *Id.*

be conducted.[214]

To stress the parties' contractual freedom, *Mastrobuono* added: "Thus, the case before us comes down to what the contract has to say about the arbitrability of petitioners' claim for punitive damages."[215] If, therefore, under applicable rules of contract interpretation, the choice of law clause is construed to incorporate a state's laws of arbitration to the exclusion of the FAA, the parties' agreement must be honored irrespective of its effect upon arbitration. Those courts taking the fourth approach to *Volt* and concluding that parties cannot lawfully agree to abide by a state law whose effect would be to prevent arbitration of a dispute are in error.[216] The apparent conflict between *Volt* and *Mastrobuono* is not with the validity of parties' agreement to bypass the preemptive provisions of the FAA but with the standard to be applied in determining whether in fact they have so agreed.

With respect to the area of apparent conflict, it is submitted that, without undermining the policies underlying the FAA, the cases can be rationally reconciled. The holding of each case should be limited in application to a distinct realm whose boundaries are defined by the impact that the designated state's laws would have upon the arbitration process.

Volt's assertion that the FAA's principle of liberal interpretation is not violated by construing an ambiguous choice of law clause to incorporate a state's rules of arbitration procedure[217] should be regarded as a declaration of its domain as should *Mastrobuono*'s assertion that an ambiguous choice of law clause must be construed "not to include special rules limiting the authority of arbitrators."[218]

If a state rule of arbitration procedure is implicated, *Volt* applies. If a state rule of arbitration substance is implicated, *Mastrobuono* applies. *Volt* thus stands for the proposition that there is no violation of the FAA's underlying policy if an ambiguous choice of law clause is interpreted to encompass a state's rules of arbitration procedure. Consequently a court, whether state or federal, is free to interpret the clause to incorporate such state rules. *Mastrobuono* stands for the proposition that there would be a violation of the FAA's policies if an ambiguous choice of law clause were interpreted to encompass a state's rules of arbitration substance and, therefore, a court, whether state or federal, is obligated to interpret the clause to exclude such state rules and incorporate the relevant provisions of the FAA.

State rules that prescribe the manner in which arbitration is to be conducted are procedural. They include rules that govern how, when, or where arbitration is to proceed. Rules concerning the process for compelling or commencing arbitration,[219] selection of the arbitrators,[220] the scope of

214. 115 S. Ct. at 1216 (citations omitted).
215. *Id.*
216. *See supra* notes 94, 98 and accompanying text.
217. *See supra* note 86 and accompanying text.
218. *See supra* note 147 and accompanying text.
219. Section 4 of the FAA requires a jury trial to resolve factual issues concerning whether a particular controversy must be submitted to arbitration. 9 U.S.C. § 4 (1994). Saturday Evening Post Co. v. Rumbleseat Press, Inc. 816 F.2d 1191, 1196 (7th Cir. 1987). The Supreme Court has never decided whether § 4 applies in state court. *See supra* note 77. Some state courts have assumed that it does. *See, e.g.*, Adler v. Rimes, 545 So. 2d 421, 422 (Fla. Dist. Ct. App. 1989); Tigner v. Shearson–Lehman Hutton, Inc., 411 S.E.2d 800, 801–02 (Ga.

discovery,[221] the manner in which the hearing is conducted,[222] and the process for confirming an award[223] are examples of procedural rules.[224]

State rules that limit arbitrators' authority by denying them the power to resolve a particular dispute or grant a particular remedy are substantive. They are, from the perspective of whether a matter is to be arbitrated or not, outcome determinative.[225] State laws that invalidate an arbitration agreement[226] or authorize a court to prevent arbitration because of waiver,[227] lack of timeliness[228] or the absence of arbitrability[229] are examples of such substantive rules as are state laws that would prohibit an arbitrator from granting a

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Ct. App. 1989). If § 4 does apply in state court, an ambiguous choice of law clause could be construed to permit application of the designated state's arbitration enforcement procedures even if they did not provide for a jury trial concerning issues of arbitrability. *See* Strauch v. Eyring, 35 Cal. Rptr. 2d 747, 749 (Ct. App. 1994) (California's arbitration enforcement rules, unlike § 4 of the FAA, do not require a jury trial on factual issues concerning arbitrability).

220. Under the FAA, if parties cannot agree upon the arbitrators, selection is made by the court. 9 U.S.C. § 5 (1994). A state may provide that if the parties have agreed to arbitrate and one party refuses to participate in selecting the arbitrator, the other party may make that selection. *See, e.g.*, ARK. CODE ANN. § 3–5–1108 (Michie 1996).

221. The FAA has generally been held to authorize but not require an arbitrator to grant discovery during arbitration. *See, e.g.*, Integrity Ins. Co. v. American Centennial Ins. Co., 885 F. Supp. 69, 72 (S.D.N.Y. 1995); Hires Parts Serv., Inc. v. NCR Corp., 859 F. Supp. 349, 353 (N.D. Ind. 1994); Corcoran v. Shearson/American Express, Inc., 596 F. Supp. 1113, 1117 (N.D. Ga. 1984); Recognition Equip., Inc. v. NCR Corp., 532 F. Supp. 271, 273–74 (N.D. Tex. 1981); Bigge Crane & Rigging Co. v. Docutel Corp., 371 F. Supp. 240, 246 (E.D.N.Y. 1973). State law may provide for no discovery during arbitration. *See, e.g.*, Greenstein v. Baxas Howell Mobley, Inc., 583 So. 2d 402, 403 (Fla. Dist. Ct. App. 1991), or require extensive discovery. *See, e.g.*, CAL. CIV. PROC. CODE §§ 1283.05–1283.1 (West 1982) (providing for discovery tantamount to that available in a judicial proceeding when the arbitrated dispute involves a personal injury claim).

222. Under the FAA, arbitrators are not required to follow formal rules of evidence. Bernhardt v. Polygraphic Co. of America, 350 U.S. 198, 203 n.4 (1956); Bowles Fin. Group, Inc. v. Stifel, Nicolaus & Co., Inc. 22 F.3d 1010, 1013 (10th Cir. 1994). States may, however, require that the arbitrator comply with formal rules of evidence. *See, e.g.*, LA. REV. STAT. ANN. § 9:4231 (West 1991).

223. Under the FAA, motions to vacate arbitration awards must be commenced within three months of the award. 9 U.S.C. § 12 (1994). A state statute may provide for a longer period, *see, e.g.*, CAL CIV. PROC. CODE § 1288 (West 1982) (100 days), or a shorter period, *see, e.g.*, CONN. GEN. STAT. ANN. § 52–420(b)(1991) (30 days); VT. STAT. ANN. tit. 12 § 5678(a) (Supp. 1995) (30 days).

224. The United States Supreme Court has not specifically ruled on the applicability of any of these FAA rules to state courts. If they are not applicable then *Volt* has relevance in an irrelevant realm inasmuch as the FAA would not preempt the state rule even if the parties had agreed to incorporate the preemptive provisions of the FAA.

225. This approach is essentially the same as that taken to determine whether a federal court is applying substantive or procedural law in federal diversity cases. Chambers v. Nasco, Inc., 501 U.S. 32, 52 (1991); Felder v. Casey, 487 U.S. 131, 151 (1988); Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 404–05 (1967); Hanna v. Plumer, 380 U.S. 460, 468 (1965); Bernhardt v. Polygraphic Co. of America, Inc., 350 U.S. 198, 203 (1956); Guarantee Trust Co. v. York, 326 U.S. 99, 109 (1945); Erie R. Co. v. Tompkins, 304 U.S. 64, 78 (1938).

The Supreme Court created this distinction to prevent forum shopping between federal and state courts. *Chambers*, 501 U.S. at 52; *Felder*, 487 U.S. at 151. The same effect will be achieved by distinguishing *Volt* and *Mastrobuono* on this basis as compared to the approach suggested in footnote 4 of *Mastrobuono*. 115 S. Ct. 1212, 1217 n.4 (1995).

226. *See supra* notes 12–21, 31 and accompanying text.

227. *See supra* notes 29–30 and accompanying text.

228. *See supra* notes 23–24, 203, 210 and accompanying text.

229. *See supra* notes 25–26 and accompanying text.

particular remedy such as attorneys' fees[230] or punitive damages.[231]

Volt entailed a state rule of arbitration procedure. While delaying arbitration, it did not preclude arbitration of a particular dispute or deny the arbitrator the power to grant a particular remedy.[232] The court was therefore free to construe the choice of law clause to encompass that state rule. *Mastrobuono* entailed a state rule of arbitration substance. It would have denied the arbitrator the power to grant the remedy of punitive damages.[233] The court was therefore obligated to construe the choice of law clause to exclude that state rule and encompass the provisions of the FAA.

The proposed interpretation of *Volt* is consistent with *Volt*'s own designation of its case[234] and consistent with a later Supreme Court case that referred to *Volt*. Although *Doctor's Associates, Inc. v. Casarotto*[235] did not attempt to address the topic addressed herein, the Supreme Court's language lends support to the proposition that *Volt* is limited in its application to cases involving rules of arbitration procedure.

> *Volt* involved an arbitration agreement that incorporated state procedural rules, one of which, on the facts of that case, called for arbitration to be stayed pending the resolution of a related judicial proceeding. The state rule examined in *Volt* determined only the efficient order of proceedings; it did not affect the enforceability of the arbitration agreement itself.[236]

When a state's arbitration laws will implicate only matters of procedure, and *Volt* is therefore applicable, there are no federally mandated rules guiding interpretation of the choice of law clause. A court is not compelled, under federal law, to interpret the clause in an inclusive or exclusive manner. The issue should be resolved under ordinary state rules of contract construction.[237] Consequently, of the four approaches attributed to *Volt*, the second approach is the proper standard concerning matters of arbitration procedure.[238]

When arbitration substance is implicated and not all of *Mastrobuono*'s justifying principles are applicable or one is in conflict with another, it is the first principle that must prevail. It is only the first principle that is one of federal law.[239] It is only that principle that justifies compelling a state to

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230. Some states preclude an arbitrator from awarding attorneys' fees. *See, e.g.*, Canon Sch. Dist. No. 50 v. W.E.S. Constr. Co., 180 Ariz. 148, 151, 882 P.2d 1274, 1277 (1994); Lee v. Smith Barney, Harris Upham & Co., 626 So. 2d 969, 970 (Fla. Dist. Ct. App. 1993); Farm Bureau Ins. Co. v. Farm Bureau Ins. Serv. Co., 913 P.2d 1168, 1173 (Idaho 1996). The FAA has been construed to authorize such relief. *See, e.g.*, PaineWebber Inc. v. Bybyk, 81 F.3d 1193, 1202 (2d Cir. 1996); R.M. Perez & Assoc., Inc. v. Welch, 960 F.2d 534, 540 (5th Cir. 1992); Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056, 1064 (9th Cir. 1991).

231. *See supra* note 27 and accompanying text.

232. One could, if the slate were blank, make a persuasive argument that *Volt* actually involved a rule of substance in that it prevented immediate arbitration and, from a practical perspective, may have induced the permanent surrender of that right. *See supra* notes 85–86 and accompanying text. But the slate isn't blank. The purpose of this Article is not to argue that *Volt* or *Mastrobuono* should be overruled. It is to clarify and reconcile the meaning of two extant Supreme Court decisions.

233. *See supra* note 127 and accompanying text.

234. *See supra* notes 87–88 and accompanying text.

235. 116 S. Ct. 1652 (1996). *See supra* notes 115–17 and accompanying text.

236. 116 S. Ct. at 1656–57.

237. *See supra* note 67 and accompanying text.

238. *See supra* note 92 and accompanying text.

239. *See supra* notes 183–85 and accompanying text.

disregard its own rules of contract construction.[240] In other contexts, the doctrine that ambiguities as to the scope of an arbitrator's powers are to be resolved in favor of arbitration is independent of and superior to all other rules of contract construction.[241] The same hierarchy should prevail in this context. Viewed from a perspective of hindsight, the third approach to *Volt* reflects the proper standard to apply in cases governed by *Mastrobuono*.[242] Therefore, only when the parties clearly and unequivocally intended a state's substantive arbitration laws to govern may a court interpret a choice of law clause to exclude the provisions of the FAA.[243]

By limiting each case to its separate domain, it is possible to reconcile *Volt*'s rejection of the same principle upon which *Mastrobuono* relied.[244] A court is not violating the principle that doubts as to the scope of arbitrable issues should be resolved in favor of arbitration when it interprets a choice of law clause to incorporate a state's procedural arbitration rules, as those rules will not determine the scope of arbitrable issues. A court is violating that principle when an ambiguous choice of law clause is interpreted to incorporate a state's substantive arbitration rules, as those rules would determine the scope of arbitrable issues.[245]

Construing the cases in the manner proposed salvages the Court's efforts to justify its deference in *Volt* with its de novo review in *Mastrobuono*.[246] Because *Volt* implicated a state rule of arbitration procedure, the Court had no authority to impose a federal rule of contract interpretation upon the choice of law clause. The lower court was free to apply state rules of contract interpretation and its decision was entitled to deference on review.[247] Because *Mastrobuono* implicated a state's substantive rule, the lower court had no equivalent freedom of interpretation.[248] It was compelled, through federal law, to resolve ambiguities as to the meaning of the choice of law clause in a manner that would favor arbitration by incorporating the provisions of the FAA.[249] Its failure to comply with federal law was subject to de novo review by the Supreme Court and constituted reversible error.[250]

The Court's statement that *Volt* involved a state court interpreting a choice of law clause while *Mastrobuono* involved a federal court,[251] although

240. *See supra* notes 182–85 and accompanying text.
241. *See supra* notes 156–57 and accompanying text.
242. *See supra* note 93 and accompanying text.
243. Under the FAA, if the parties clearly agreed to withhold a particular dispute from arbitration, that agreement must be enforced. *See, e.g.*, First Options of Chicago, Inc. v. Kaplan, 115 S. Ct. 1920, 1924 (1995).
244. *Volt*, 489 U.S. 468, 475 (1989). Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212, 1218 n.8 (1995).
245. The Supreme Court's list of examples to which the principle is applicable indicates its substantive orientation. It applies "whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Mastrobuono*, 115 S. Ct. at 1218 n.8 (quoting Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24–25 (1983)). Its breadth also suggests its limitation. It assures that the right to arbitration will not be readily defeated. It does not concern the manner in which arbitration will take place.
246. *See supra* note 150 and accompanying text.
247. *See supra* notes 67, 176–77, 237 and accompanying text.
248. *See supra* notes 182–85, 240 and accompanying text.
249. *See supra* notes 182–85, 240 and accompanying text.
250. *See supra* notes 182–85, 240 and accompanying text.
251. *See supra* note 149 and accompanying text.

true, should not be regarded as determinative. The distinction should not be with the status of the court but with the impact that the designated state's law would have upon the arbitration process. To conclude that *Mastrobuono* intended the cases to be distinguished on the basis of the forum would undermine its explicit and repeated statement that Congress intended the FAA to have universal impact, irrespective of the court, in order to avoid the forum shopping that would otherwise ensue.[252]

Similarly, the Court's statement that *Volt*'s interpretation was prior to arbitration,[253] while *Mastrobuono*'s was consistent with the arbitrators' determination of their own power,[254] should be regarded as an irrelevant truth. That conclusion is necessitated by the Supreme Court's decision in *First Options of Chicago, Inc. v. Kaplan*,[255] stating that unless the parties clearly intended otherwise, arbitrators are not empowered to determine the ambit of their own authority.[256]

CONCLUSION

By limiting *Volt* and *Mastrobuono* to their proposed respective spheres, a workable compromise is achieved between the doctrine that contracts are ordinarily interpreted pursuant to state law, and the doctrine that ambiguities concerning the interpretation of arbitration agreements involving commerce, as a matter of federal law, are to be resolved in favor of arbitration.

State law will govern the interpretation of the clause when the designated law affects arbitration procedure. Federal law will govern when the designated law affects arbitration substance. The relevant law will be applicable irrespective of whether the matter is being resolved in state or federal court. By this process, the arbitration-centered forum shopping that the Supreme Court has continually sought to curtail will continue to be curtailed.

The longer *Volt* and *Mastrobuono* remain unreconciled, the greater will be the confusion and disparity of opinion among state and federal courts. It is hoped that these cases will be harmonized in a manner that promotes, rather than undermines, the purposes of the FAA.

252. *See supra* notes 172–75 and accompanying text.
253. *See supra* note 149 and accompanying text.
254. *See supra* note 149 and accompanying text.
255. 115 S. Ct. 1920 (1995). *See supra* note 192 and accompanying text.
256. 115 S. Ct. at 1924.