Determining the Procedural Law Which Governs The Arbitration: A Basic Outline

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Mealey's Fundamentals of Reinsurance
Litigation and Arbitration Conference
March 23 & 24, 2006

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Introduction

One of the first questions that you need to determine, after reaching the conclusion that your dispute is subject to arbitration (no small matter in itself), is what law will control the procedural elements of the arbitration. This question may prove very simple to resolve; or decidedly more complex. Which course the determination takes is largely dependent on how carefully the contract was drafted.

In either event, the importance of promptly and correctly resolving this governing law question cannot be underestimated. Its resolution may, under some circumstances, result in dramatically different discovery obligations. It may broadly alter the powers of your arbitrators to control discovery and provide assistance with third-party discovery. Depending on which law governs the arbitration, your time for timely filing a motion to vacate a disagreeable panel award may vary by several days and the grounds on which you may contest an award may change in very important substantive ways. In fact, in certain circumstances, your very arbitration may arguably be invalidated based on the action or inaction of your arbitrators. In sum: you really do not know what type of arbitration you will have until you have confirmed what law will govern its procedures.

Two recent court decisions have underscored the importance of promptly and correctly deciding which law governs the arbitration procedure. In the Second Circuit's recent decision in *Security Ins. Co. of Hartford v. TIG Ins. Co.*, 360 F.3d 322 (2d Cir. 2004) (a copy of the decision follows this paper), the Court held that a reinsurance arbitration may be stayed pending the outcome of related litigation, based on an application of the California Code of Civil Procedure where the reinsurance agreement designated California law as controlling. This outcome is in stark contrast to the priority typically given to arbitration over litigation under the Federal Arbitration Act, 9 U.S.C. §1, *et. seq.* (the "FAA"). The application of the California Code rather than the FAA, as a very practical matter, resulted in the arbitration being stayed, rather than the litigation.

Even more recently, the United States Supreme Court reached a decision that re-emphasized the importance of clearly deciding which jurisdictional law governs your arbitration before proceeding headlong into arbitration. In *Buckeye Check Cashing, Inc. v. Cardegna, et al.*, No. 04-1264 (U.S., Feb. 21, 2006) (a copy of this decision also follows this paper), the Supreme Court concluded that the question of a contract's validity is to be considered by the arbitrator in the first instance, not resolved by a court, even though the state law applicable to the contract generally would leave the issue to a court's resolution. The Court based its decision on the view that the FAA and related federal arbitration case law preempted the application of state law and ultimately governed the dispute, even though the state court had properly exercised jurisdiction over the contract and had reached an opposite conclusion based on the application of conflicting Florida state arbitration law. In *Buckeye*, the arbitration agreement expressly provided that the FAA was to govern. Again, which law governed the procedure of the arbitration made a significant difference.

This paper is intended to provide the reinsurance practitioner with a basic outline for and case law relevant to determining the answer to the question of which law will control the procedure of the arbitration. As always, the specific facts of the arbitration clause and the particular substantive law of the jurisdiction considering the question will vary.[1] Experienced counsel should be consulted in resolving these questions based on the specific facts presented and relevant law. Should you find yourself faced with a particularly challenging dilemma, we encourage you to contact the authors to discuss your situation further.

Begin at the Beginning: Some Basic Choices

In deciding which law will govern, you might first ask: what procedural law options are available? Focusing for the moment on just the United States jurisdictional options, the choices for governing law largely come down to either the FAA or one of the various state arbitration acts.

The FAA can be found in 9 U.S.C. §1 *et. seq.* and is implicated whenever interstate commerce is at issue. As a general rule, contracts of reinsurance typically involve interstate commerce and therefore trigger application of the FAA. *See, e.g., Security Life Ins. Co. of Am. v. Hannover Life Reassurance Co. of Am.*, 167 F. Supp. 2d 1086, 1088 (D. Minn. 2001) ("Reinsurance contracts fall under the protection of the Federal Arbitration Act."); *Utica Mutual Ins. Co. v. Gulf Ins. Co.*, 762 N.Y.S.2d 730, 732 (N.Y. App. Div. 2003).

Notwithstanding that the FAA has often been applied, sometimes without question or serious consideration, by many a federal court, this does not mean state arbitration laws can be safely ignored. State arbitration laws may still be properly found to apply to govern the procedure of an arbitration arising from a particular reinsurance contract, even when the contract clearly involves interstate commerce. When a state's procedural law may apply, the specific law must be carefully researched and considered. While there has been considerable effort to attempt to achieve some measure of uniformity among the various state arbitration acts, by the promulgation of the Uniform Arbitration Act and, more recently, the Revised Uniform Arbitration Act, there still remains considerable diversity among the various states. As mentioned above, these differences can have some dramatic impacts on the practical outcome of the dispute.

A Clear Choice of Procedural Law: Say What You Mean and Mean What You Say

Determining which jurisdiction's law applies to your dispute may be as simple as reading the contract. Many modern reinsurance contracts contain a clear choice of law provision which expressly adopts a particular jurisdiction's law to govern the arbitration procedures.

When such a provision exists and is clear, the selected law will typically govern the arbitration. *See, e.g, Volt Info. Sci., Inc. v. Board of Trs. Of Leland Stanford Junior Univ.*,

[1] Opinions expressed in this paper are not necessarily those of Larson • King, LLP or its clients.

489 U.S. 468, 477 (1989) (affirming stay of arbitration as required by California state law where parties' agreement provided that California law was to apply); *Security Ins. Co. of Hartford v. TIG Ins. Co.*, 360 F.3d 322, 328 (2d Cir. 2004) (affirming stay of arbitration as required by California state law where agreement contained broad choice-of-law provision). Likewise, if an agreement expressly and clearly adopts the FAA, it will be likely applied. *See Rodriguez v. Am. Tech., Inc.*, No. G034933 (Cal. Ct. App., Feb. 16, 2006) (reversing denial of motion to compel arbitration despite California state law where parties' agreement was made pursuant to the FAA).

Federal Preemption: The Federal Empire Strikes Back

A clear choice of law, even a clear choice of procedure, is not, however, a complete guarantee that the selected jurisdiction's law will govern the procedural aspects of the arbitration. Indeed, federal courts have many times rejected the chosen jurisdiction's law and, instead, applied the FAA to govern the arbitration's procedure. This is particularly likely when the choice of law clause is not clear about its application to the arbitration procedure.

If there is any ambiguity about whether a choice-of-law provision also incorporates a jurisdiction's procedural rules of arbitration, the courts have often read the provision so as to favor arbitration consistent with the pro-arbitration policy of the Federal Arbitration Act. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62 (1995) (holding that ambiguous choice-of-law clause only incorporated the state's substantive law, not its procedural arbitration statute). Therefore, a mere venue clause will often not be read to be a choice-of-law clause. *Certain Underwriters at Lloyd's London v. Argonaut Ins. Co.*, 264 F.Supp.2d 926, 933 (N.D.Cal. 2003). Moreover, it should be noted that if a state law is clearly anti-arbitration, the courts are likely to find it unenforceable under the Federal Arbitration Act, even in light of a broad state choice-of-law clause. *See, e.g., Ainsworth v. Allstate Ins. Co.*, 634 F.Supp. 52, 54 (W.D. Mo. 1985) (applying Federal Arbitration Act despite broad choice-of-law clause where state law would have made the arbitration agreement unenforceable).[2]

Reverse Preemption: Just When You Thought It Was Safe to Go Back Into the Water

Even when a contract clearly arises from interstate commerce and does not include a clear choice of law, it still may be interpreted to require a particular state's arbitration procedure, over the FAA. This result, while not common, typically is justified by application of a doctrine known as "reverse preemption."

The McCarran-Ferguson Act was adopted to prevent generic federal statutes from preempting state statutes that regulate insurance. 15 U.S.C. §§ 1011-1015. One section

[2] While *Ainsworth* is still technically good law, it is unclear whether it would continue to be followed after *Volt*. Nevertheless, courts highly disfavor state statutes that prohibit arbitration completely. *See, e.g., Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995) (refusing to apply state arbitration statute that would have invalidated arbitration provision under a broad interpretation of "interstate commerce").

of the Act specifically addresses reverse preemption (sometimes also known as "inverse preemption"):

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance . . .

15 U.S.C. § 1012(b). Relying on this language, the courts apply a three-part test to determine if a state arbitration statute would control over (or reverse preempt) the federal statute:

1) The federal statute at issue does not specifically relate to the business of insurance.

2) The state statute at issue was enacted for the purpose of regulating the business of insurance.

3) Application of the federal statute would invalidate, impair, or supersede the state statute.

See, e.g., Munich Amer. Reins. Co. v. Crawford, 141 F.3d 585, 590 (5th Cir. 1998). If all three elements are satisfied, the state statute will control, thus reverse preempting the federal statute.

As a general matter, the first and third elements are easily satisfied in issues of arbitration.

The first element requires that the federal statute not specifically relate to the business of insurance. In reinsurance arbitrations, the federal statute that may be implicated is the Federal Arbitration Act. Universally, courts have held that the Federal Arbitration Act does not specifically relate to the business of insurance. *See, e.g., Munich*, 141 F.3d at 590; *Stephens v. American Internat'l Ins. Co.*, 66 F.3d 41, 44 (2d Cir. 1995). Therefore, the first element is almost certainly satisfied.[3]

The third element requires a showing that the federal statute, if applied, would invalidate, impair, or supersede the relevant state statute. Here, the focus is often on the lack of any specific state statute. For example, in *Miller v. National Fidelity Life Insurance Company*, the plaintiff argued that the Federal Arbitration Act was precluded by the McCarran-Ferguson Act because Georgia had enacted statutes that regulate the business

[3] An example of a federal statute that specifically relates to the business of insurance is the Federal Crop Insurance Act. 7. U.S.C. § 1501 *et seq.* Because that statute, which mandates arbitration, specifically relates to the business of insurance, the McCarran-Ferguson Act does not apply. *In re 2000 Sugar Beet Crop Ins. Litig.*, 228 F.Supp.2d 992, 997 (D.Minn. 2002); *IGF Ins. Co. v. Hat Creek P'ship*, 76 S.W.3d 859, 864 (Ark. 2002). Therefore, in cases arising under the Federal Crop Insurance Act, the Federal Arbitration Act continues to preempt any contrary state law. *Id.*

of insurance. 588 F.2d 185, 187 (5th Cir. 1979). There was no specific state statute, however, forbidding arbitration of insurance disputes. *Id.* Because no state statute was invalidated, impaired, or superseded, then, the Federal Arbitration Act controlled, and arbitration was required under the parties' agreement. *Id. See also Quackenbush v. Allstate Ins. Co.*, 121 F.3d 1372, 1381-82 (9th Cir. 1997) (affirming order to arbitrate because no state statute prohibited the arbitration of offset issues in the context of a liquidation proceeding); *Bernstein v. Comm'r of Banking and Ins. of Vt*, 606 F.Supp. 98, 103 (S.D.N.Y. 1984) (allowing arbitration where no state statute prohibited it even though state case law might).

The second element, then, asks whether the state statute was enacted for the purpose of regulating the business of insurance. In analyzing the state statute at issue, the United States Supreme Court has stated that statutes regulating the "business of insurance" within the meaning of McCarran-Ferguson are statutes that are aimed at protecting or regulating the relationship between an insurance company and its policyholders. *SEC v. Nat'l Sec., Inc.*, 393 U.S. 453, 460 (1969). Courts will look at three factors to determine whether the practice that the state statute regulates falls within the "business of insurance": 1) whether the practice has the effect of transferring or spreading the risk; 2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and 3) whether the practice is limited to entities within the insurance industry. *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982) (summarizing and applying the criteria developed in *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979)). None of these factors alone is determinative; rather, a court will examine all three in determining whether a practice falls within the "business of insurance," and, therefore, within McCarran-Ferguson. *Id.* Reinsurance is likely to be considered a practice that is within the "business of insurance." *See, e.g., Stephens*, 66 F.3d at 44 ("Reinsurance practices fall within this test.").

Generally, courts have reviewed two types of statutes under McCarran-Ferguson: general arbitration statutes and statutes regulating the liquidation of insurance companies (which sometimes involve arbitration). Under either type of statute, you must determine whether a statute is aimed at protecting or regulating the relationship between an insurance company and its policyholders.

Many states have adopted statutes governing arbitration. When those statutes are general, without any specific reference to insurance, they will still usually be preempted by the Federal Arbitration Act. That is because general arbitration statutes do not specifically regulate the business of insurance, but rather regulate dispute resolution generally. *See Hamilton Life Ins. Co. of N.Y. v. Republic Nat'l Life Ins. Co.*, 408 F.2d 606, 611 (2d Cir. 1969) (holding that the Federal Arbitration Act was not reverse preempted by the New York or Texas arbitration statutes because those statutes did not regulate the business of insurance); *Ainsworth v. Allstate Ins. Co.*, 634 F.Supp. 52, 56 (W.D. Mo. 1985) (concluding that state common-law rule against arbitration was not within the category of laws regulating insurance).

Of the states that have adopted a uniform arbitration act, many expressly exclude contracts of insurance from their reach.[4] Under those state laws, arbitration provisions in insurance contracts are unenforceable. Most, however, exempt reinsurance contracts or contracts between insurance companies.[5] Therefore, even under these more restrictive state laws, arbitration provisions in reinsurance contracts would remain enforceable. When a more specific exclusion is at issue, the McCarran-Ferguson analysis is different.

In the context of direct insurance policies, courts consistently find that a state statute that makes arbitration provisions in insurance contracts unenforceable is a statute regulating the business of insurance. *See, e.g., Amer. Bankers Ins. Co. of Fla. v. Inman*, 2006 WL 52273 (5th Cir.) (holding that Federal Arbitration Act was reverse preempted under McCarran-Ferguson Act in light of Mississippi statute); *McKnight v. Chicago Title Ins. Co., Inc.*, 358 F.3d 854, 855 (11th Cir. 2004) (reverse preemption in light of Georgia statute); *Standard Sec. Life Ins. Co. of N.Y. v. West*, 267 F.3d 821, 824-25 (8th Cir. 2001) (reverse preemption in light of Missouri statute); *Nat'l Home Ins. Co. v. King*, 291 F.Supp.2d 518, 530 (E.D. Ky. 2003) (reverse preemption in light of Kentucky statute). In those instances, the Federal Arbitration Act is reverse preempted by the McCarran–Ferguson Act, and the state statute controls, thus making the arbitration provision unenforceable.

Courts have reached the same conclusion in the context of reinsurance. For example, at one time, Kansas' arbitration statute provided that arbitration provisions were unenforceable in contracts of insurance. *Mut. Reins. Bureau v. Great Plains Mut. Ins. Co., Inc.*, 969 F.2d 931, 932 (10th Cir. 1992). Applying the three-part test, the Tenth Circuit Court of Appeals concluded that this statute regulated the "business of insurance," and that the "business of insurance" also includes reinsurance. *Id.* at 933. Therefore, under McCarran-Ferguson, the state law controlled and the arbitration clause in the reinsurance agreement was unenforceable. *Id.* at 934.[6] *See also Oil Ins. Ass'n v. Royal Indem. Co.*, 519 S.W.2d 148, 151 (Tex. Civ. App. 1975) (applying general state statute invalidating arbitration provisions in insurance contracts to a reinsurance agreement).[7]

[4] Specifically, Arkansas, Georgia, Kansas, Kentucky, Missouri, Montana, Nebraska, South Carolina, South Dakota, and Vermont all have arbitration statutes that exclude insurance contracts. Maine and Mississippi both exclude policies of automobile liability under their uninsured motorist coverage statutes, and Rhode Island excludes policies of primary insurance; presumably, these statutes would not affect contracts of reinsurance.

[5] Kansas, Kentucky, Missouri, and Nebraska specifically provide that their arbitration statutes apply to contracts of reinsurance. Georgia, Montana, and South Dakota have arbitration statutes that apply to contracts between insurance companies, presumably including reinsurance contracts. This leaves only Arkansas, South Carolina, and Vermont that would arguably invalidate arbitration provisions in reinsurance agreements.

[6] Since *Mutual Reinsurance* was decided, Kansas has amended its arbitration statute to provide that reinsurance contracts are not to be considered as contracts of insurance. K.S.A. § 5-401. In fact, this is consistent with the position taken by most states that exclude insurance contracts from their arbitration statutes, but expressly exempt reinsurance contracts from that exclusion. *See supra* note 5 and accompanying text.

As to liquidation statues, most courts conclude that such statutes regulate the business of insurance because they offer the policyholder the protection of an orderly liquidation.[8] *United States Dept. of Treasury v. Fabe*, 508 U.S. 491, 505-06 (1993); *Munich*, 141 F.3d at 592; *Stephens*, 66 F.3d at 44-45. If the liquidation statute expressly prohibits arbitration, a court is likely to conclude that McCarran-Ferguson saves the state statute from preemption by the Federal Arbitration Act. *See, e.g., Stephens*, 66 F.3d at 44 (applying Kentucky Liquidation Act that voided arbitration provisions in insurance contracts once the insurance company is in liquidation). In those instances, the arbitration provision will be overtaken by litigation.

The liquidation statute need not expressly prohibit arbitration, however. If, for example, it provides that all matters involving an insurance company in liquidation must be consolidated in one court, this may be a state statute that reverse preempts the Federal Arbitration Act. *See Davister Corp. v. United Rep. Life Ins. Co.*, 152 F.3d 1277, 1281 (10th Cir. 1998) (applying reverse preemption so that Utah statute controlled). Or, if the state liquidation statute provides exclusive original jurisdiction in the state court, the arbitration provision may be invalid. *See Munich*, 141 F.3d at 596 (applying reverse preemption so that Oklahoma statute controlled).

Conclusion

It is critically important, if for no other reason than to know what deadlines may apply to your arbitration, to confirm which laws govern the procedure of the arbitration. This resolution may be simply answered by a clear and broadly-worded choice of law clause that plainly describes an election by the contracting parties of a particular jurisdiction's arbitration laws. In such a case, it is merely important for you to educate yourself of the particulars of that jurisdiction's arbitration act.

If the contract is not so clear, further effort must be undertaken to carefully and properly resolve the issue of which law will govern the arbitration and describe the procedure to be followed. This paper describes in a general manner some of the important elements of this consideration.

[7] Like Kansas, Texas has since revised its arbitration act. Texas no longer excludes insurance contracts. TEX. CIV. PRAC. & REM. § 171.002.

[8] In one case, the court allowed arbitration, concluding that Colorado's liquidation statute did not regulate the "business of insurance" under McCarran-Ferguson. *Phillips v. Lincoln Nat'l Health & Cas. Ins. Co.*, 774 F.Supp. 1297, 1300 (D. Colo. 1991). The case, however, contains no explanation of the court's reasoning and actually cites to the dissent of one of the leading cases on the definition of "business of insurance," *U.S. Dept. of Treasury v. Fabe*, 508 U.S. 491 (1993).

BUCKEYE CHECK CASHING, INC., PETITIONER v. JOHN CARDEGNA ET AL.

No. 04-1264

SUPREME COURT OF THE UNITED STATES

2006 U.S. LEXIS 1814

November 29, 2005, Argued
February 21, 2006, Decided

NOTICE: [*1]

The LEXIS pagination of this document is subject to change pending release of the final published version.

PRIOR HISTORY: ON WRIT OF CERTIORARI TO THE SUPREME COURT OF FLORIDA. *Cardegna v. Buckeye Check Cashing, Inc., 894 So. 2d 860, 2005 Fla. LEXIS 51 (Fla., 2005)*

DISPOSITION: Reversed and remanded.

SYLLABUS: For each deferred-payment transaction respondents entered into with Buckeye Check Cashing, they signed an Agreement containing provisions that required binding arbitration to resolve disputes arising out of the Agreement. Respondents sued in Florida state court, alleging that Buckeye charged usurious interest rates and that the Agreement violated various Florida laws, rendering it criminal on its face. The trial court denied Buckeye's motion to compel arbitration, holding that a court rather than an arbitrator should resolve a claim that a contract is illegal and void *ab initio*. A state appellate court reversed, but was in turn reversed by the [*2] Florida Supreme Court, which reasoned that enforcing an arbitration agreement in a contract challenged as unlawful would violate state public policy and contract law.

Held: Regardless of whether it is brought in federal or state court, a challenge to the validity of a contract as a whole, and not specifically to the arbitration clause within it, must go to the arbitrator, not the court. *Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270*, and *Southland Corp. v. Keating, 465 U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1*, answer the question presented here by establishing three propositions. First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. See *Prima Paint, 388 U.S., at 400, 402-404*. Second, unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance. See *id., at 403-404*. Third, this arbitration law applies in state as well as federal courts. See *Southland, supra, at 12*. The crux of respondents' claim is that the Agreement as a whole (including [*3] its arbitration provision) is rendered invalid by the usurious finance charge. Because this challenges the Agreement, and not specifically its arbitration provisions, the latter are enforceable apart from the remainder of the contract, and the challenge should be considered by an arbitrator, not a court. The Florida Supreme Court erred in declining to apply *Prima Paint's* severability rule, and respondents' assertion that that rule does not apply in state court runs contrary to *Prima Paint* and *Southland*. Pp. 3-8.

894 So. 2d 860, reversed and remanded.

JUDGES: SCALIA, J., delivered the opinion of the Court, in which ROBERTS, C. J., and STEVENS, KENNEDY, SOUTER, GINSBURG, and BREYER, JJ., joined. THOMAS, J., filed a dissenting opinion. ALITO, J., took no part in the consideration or decision of the case.

OPINIONBY: SCALIA

OPINION:

JUSTICE SCALIA delivered the opinion of the Court.

We decide whether a court or an arbitrator should consider the claim that a contract containing an arbitration provision is void for illegality.

I

Respondents John Cardegna and Donna Reuter entered into various deferred-payment transactions with petitioner Buckeye Check Cashing (Buckeye), [*4] in which they received cash in exchange for a personal check in the amount of the cash plus a finance charge. For each separate transaction they signed a "Deferred Deposit and Disclosure Agreement" (Agreement), which included the following arbitration provisions:

"1. *Arbitration Disclosure* By signing this Agreement, you agree that if a dispute of any kind arises out of this Agreement or your application therefore or any instrument relating thereto, then either you or we or third-parties involved can choose to have that dispute resolved by binding arbitration as set forth in Paragraph 2 below . . . .

2. *Arbitration Provisions* Any claim, dispute, or controversy . . . arising from or relating to this Agreement . . . or the validity, enforceability, or scope of this Arbitration Provision or the entire Agreement (collectively 'Claim'), shall be resolved, upon the election of you or us or said third-parties, by binding arbitration . . . . This arbitration Agreement is made pursuant to a transaction involving interstate commerce, and shall be governed by the Federal Arbitration Act ('FAA'), 9 U.S.C. Sections 1-16. The arbitrator shall apply applicable substantive [*5] law constraint *[sic]* with the FAA and applicable statutes of limitations and shall honor claims of privilege recognized by law . . . ."

Respondents brought this putative class action in Florida state court, alleging that Buckeye charged usurious interest rates and that the Agreement violated various Florida lending and consumer-protection laws, rendering it criminal on its face. Buckeye moved to compel arbitration. The trial court denied the motion, holding that a court rather than an arbitrator should resolve a claim that a contract is illegal and void *ab initio*. The District Court of Appeal of Florida for the Fourth District reversed, holding that because respondents did not challenge the arbitration provision itself, but instead claimed that the entire contract was void, the agreement to arbitrate was enforceable, and the question of the contract's legality should go to the arbitrator.

Respondents appealed, and the Florida Supreme Court reversed, reasoning that to enforce an agreement to arbitrate in a contract challenged as unlawful "'could breathe life into a contract that not only violates state law, but also is criminal in nature . . . .'" *894 So. 2d 860, 862 (2005)* [*6] (quoting *Party Yards, Inc. v. Templeton, 751 So. 2d 121, 123 (Fla. App. 2000)*). We granted certiorari. *545 U.S. ___, 125 S. Ct. 2937, 162 L. Ed. 2d 864 (2005)*.

II

A

To overcome judicial resistance to arbitration, Congress enacted the Federal Arbitration Act (FAA), *9 U.S.C. § § 1-16*. *Section 2* embodies the national policy favoring arbitration and places arbitration agreements on equal footing with all other contracts:

"A written provision in . . . a contract . . . to settle by arbitration a controversy thereafter arising out of such contract . . . or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

Challenges to the validity of arbitration agreements "upon such grounds as exist at law or in equity for the revocation of any contract" can be divided into two types. One type challenges specifically the validity of the agreement to arbitrate. See, *e.g., Southland Corp. v. Keating, 465 U.S. 1, 4-5, 104 S. Ct. 852, 79 L. Ed. 2d 1 (1984)* (challenging the agreement to arbitrate as void under California [*7] law insofar as it purported to cover claims brought under the state Franchise Investment Law). The other challenges the contract as a whole, either on a ground that directly affects the entire agreement (*e.g.*, the agreement was fraudulently induced), or on the ground that the illegality of one of the contract's provisions renders the whole contract invalid. n1 Respondents' claim is of this second type. The crux of the complaint is that the contract as a whole (including its arbitration provision) is rendered invalid by the usurious finance charge.

n1 The issue of the contract's validity is different from the issue of whether any agreement between the alleged obligor and obligee was ever concluded. Our opinion today addresses only the former, and does not speak to the issue decided in the cases cited by respondents (and by the Florida Supreme Court), which hold that it is for courts to decide whether the alleged obligor ever signed the contract, *Chastain v. Robinson-Humphrey Co., 957 F.2d 851 (CA11 1992)*, whether the signor lacked authority to commit the alleged principal, *Sandvik AB v. Advent Int'l Corp., 220 F.3d 99 (CA3 2000)*; *Sphere Drake Ins. Ltd. v. All American Ins. Co., 256 F.3d 587 (CA7 2001)*, and whether the signor lacked the mental capacity to assent, *Spahr v. Secco, 330 F.3d 1266 (CA10 2003)*.

[*8]

In *Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967)*, we addressed the question of who -- court or arbitrator -- decides these two types of challenges. The issue in the case was "whether a claim of fraud in the inducement of the entire contract is to be resolved by the federal court, or whether the matter is to be referred to the arbitrators." *Id., at 402, 87 S. Ct. 1801, 18 L. Ed. 2d 1270.* Guided by *§ 4 of the FAA*, n2 we held that "if the claim is fraud in the inducement of the arbitration clause itself -- an issue which goes to the making of the agreement to arbitrate -- the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Id., at 403-404, 87 S. Ct. 1801, 18 L. Ed. 2d 1270* (internal quotation marks and footnote omitted). We rejected the view that the question of "severability" was one of state law, so that if state law held the arbitration provision not to be severable a challenge to the contract as a whole would be decided by the court. See *id., at 400, 402-403, 87 S. Ct. 1801, 18 L. Ed. 2d 1270.*

n2 In pertinent part, *§ 4* reads:

> "A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court [with jurisdiction] . . . for an order directing that such arbitration proceed in a manner provided for in such agreement . . . . 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 . . . ."

[*9]

Subsequently, in *Southland Corp.*, we held that the FAA "created a body of federal substantive law," which was "applicable in state and federal court." *465 U.S., at 12, 104 S. Ct. 852, 79 L. Ed. 2d 1* (internal quotation marks omitted). We rejected the view that state law could bar enforcement of *§ 2*, even in the context of state-law claims brought in state court. See *id., at 10-14, 104 S. Ct. 852, 79 L. Ed. 2d 1*; see also *Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 270-273, 115 S. Ct. 834, 130 L. Ed. 2d 753 (1995).*

B

Prima Paint and *Southland* answer the question presented here by establishing three propositions. First, as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract. Second, unless the challenge is to the arbitration clause itself, the issue of the contract's validity is considered by the arbitrator in the first instance. Third, this arbitration law applies in state as well as federal courts. The parties have not requested, and we do not undertake, reconsideration of those holdings. Applying them to this case, we conclude that because respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions [*10] are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court.

In declining to apply *Prima Paint*'s rule of severability, the Florida Supreme Court relied on the distinction between void and voidable contracts. "Florida public policy and contract law," it concluded, permit "no severable, or salvageable, parts of a contract found illegal and void under Florida law." *894 So. 2d, at 864. Prima Paint* makes this conclusion irrelevant. That case rejected application of state severability rules to the arbitration agreement *without discussing* whether the challenge at issue would have rendered the contract void or voidable. See *388 U.S., at 400-404, 87 S. Ct. 1801, 18 L. Ed. 2d 1270.* Indeed, the opinion expressly disclaimed any need to decide what state-law remedy was available, *id., at 400, n. 3, 87 S. Ct. 1801, 18 L. Ed. 2d 1270*, (though Justice Black's dissent *asserted* that state law rendered the contract void, *id., at 407, 87 S. Ct. 1801, 18 L. Ed. 2d 1270*). Likewise in *Southland*, which arose in state court, we did not ask whether the several challenges made there -- fraud, misrepresentation, breach of contract, breach of fiduciary duty, and [*11] violation of the California Franchise Investment Law -- would render the contract void or voidable. We simply rejected the proposition that the enforceability of the arbitration agreement turned on the state legislature's judgment concerning the forum for enforcement of the state-law cause of action. See *465 U.S., at 10, 104 S. Ct. 852, 79 L. Ed. 2d 1.* So also here, we cannot accept the Florida Supreme Court's conclusion that enforceability of the arbitration agreement should turn on "Florida public policy and contract law," *894 So. 2d, at 864.*

C

Respondents assert that *Prima Paint*'s rule of severability does not apply in state court. They argue that *Prima Paint* interpreted only *§§ 3* and *4* -- two of the FAA's procedural provisions, which appear to apply by their terms only in federal court -- but not *§ 2*, the only provision that we have applied in state court. This does not accurately describe *Prima Paint*. Although *§ 4*, in particular, had much to do with *Prima Paint*'s understanding of the rule of severability, see *388 U.S., at 403-404, 87 S. Ct. 1801, 18 L. Ed. 2d 1270*, this rule ultimately arises out of *§ 2, the FAA*'s substantive command that arbitration agreements be treated like all other [*12] contracts. The rule of severability establishes how this equal-footing guarantee for "a written [arbitration] provision" is to be implemented. Respondents' reading of *Prima Paint* as establishing nothing more than a federal-court rule of procedure also runs contrary to *Southland*'s understanding of that case. One of the bases for *Southland*'s application of *§ 2* in state court was precisely *Prima Paint*'s "reliance for [its] holding on Congress' broad power to fashion substantive rules under the *Commerce Clause.*" *465 U.S., at 11, 104 S. Ct. 852, 79 L. Ed. 2d 1*; see also *Prima Paint, supra, at 407, 87 S. Ct. 1801, 18 L. Ed. 2d 1270* (Black, J., dissenting) ("the Court here holds that the [FAA], as a matter of *federal substantive law* . . ." (emphasis added)). *Southland* itself refused to "believe Congress intended to limit the Arbitration Act to disputes subject only to *federal*-court jurisdiction." *465 U.S., at 15, 104 S. Ct. 852, 79 L. Ed. 2d 1.*

Respondents point to the language of *§ 2*, which renders "valid, irrevocable, and enforceable" "a written provision in" or "an agreement in writing to submit to arbitration an existing controversy arising out of" a "contract." Since, respondents argue, the only [*13] arbitration agreements to which *§ 2* applies are those involving a "contract," and since an agreement void *ab initio* under state law is not a "contract," there is no "written provision" in or "controversy arising out of" a "contract," to which *§ 2* can apply. This argument echoes Justice Black's dissent in *Prima Paint*: "*Sections 2* and *3* of the Act assume the existence of a valid contract. They merely provide for enforcement where such a valid contract exists." *388 U.S., at 412-413, 87 S. Ct. 1801, 18 L. Ed. 2d 1270.* We do not read "contract" so narrowly. The word appears four times in *§ 2*. Its last appearance is in the final clause, which allows a challenge to an arbitration provision "upon such grounds as exist at law or in equity for the revocation of any *contract*." (Emphasis added.) There can be no doubt that "contract" as used this last time must include contracts that later prove to be void. Otherwise, the grounds for revocation would be limited to those that rendered a contract voidable -- which would mean (implausibly) that an arbitration agreement could be challenged as voidable but not as void. Because the sentence's final use of "contract" so obviously includes putative contracts, [*14] we will not read the same word earlier in the same sentence to have a more narrow meaning. n3 We note that neither *Prima Paint* nor *Southland* lends support to respondents' reading; as we have discussed, neither case turned on whether the challenge at issue would render the contract voidable or void.

n3 Our more natural reading is confirmed by the use of the word "contract" elsewhere in the United States Code to refer to putative agreements, regardless of whether they are legal. For instance, the Sherman Act, 26 Stat. 209, as amended, states that "every contract, combination . . ., or conspiracy in restraint of trade . . . is hereby declared to be illegal." *15 U.S.C. § 1.* Under respondents' reading of "contract," a bewildering circularity would result: A contract illegal because it was in restraint of trade would not be a "contract" at all, and thus the statutory prohibition would not apply.

* * *

It is true, as respondents assert, that the *Prima Paint* rule permits a court to enforce [*15] an arbitration agreement in a contract that the arbitrator later finds to be void. But it is equally true that respondents' approach permits a court to deny effect to an arbitration provision in a contract that the court later finds to be perfectly enforceable. *Prima Paint* resolved this conundrum -- and resolved it in favor of the separate enforceability of arbitration provisions. We reaffirm today that, regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator.

The judgment of the Florida Supreme Court is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

JUSTICE ALITO took no part in the consideration or decision of this case.

DISSENT:

JUSTICE THOMAS, dissenting.

I remain of the view that the Federal Arbitration Act (FAA), *9 U.S.C. § 1 et seq.*, does not apply to proceedings in state courts. See *Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 285-297, 115 S. Ct. 834, 130 L. Ed. 2d 753 (1995)* (THOMAS, J., dissenting); *Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681, 689, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996)* [*16] (same); *Green Tree Financial Corp. v. Bazzle, 539 U.S. 444, 460, 123 S. Ct. 2402, 156 L. Ed. 2d 414 (2003)* (same). Thus, in state-court proceedings, the FAA cannot be the basis for displacing a state law that prohibits enforcement of an arbitration clause contained in a contract that is unenforceable under state law. Accordingly, I would leave undisturbed the judgment of the Florida Supreme Court.

LEXSEE 360 F. 3D 322

SECURITY INSURANCE COMPANY OF HARTFORD, Plaintiff-Appellee, TRUSTMARK INSURANCE COMPANY, Defendant-Third-Party-Plaintiff-Appellee, –v.– TIG INSURANCE COMPANY, Third-Party-Defendant-Appellant.

Docket No. 03-7773

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

360 F.3d 322; 2004 U.S. App. LEXIS 3942

November 21, 2003, Argued
March 2, 2004, Decided

SUBSEQUENT HISTORY: US Supreme Court certiorari denied by *Tig Ins. Co. v. Sec. Ins. Co. Hartford, 2004 U.S. LEXIS 6581 (U.S., Oct. 4, 2004)*

PRIOR HISTORY: [**1] Appeal from an order of the United States District Court of the District of Connecticut (Dorsey, Judge), entered on August 5, 2003, granting appellee's motion to stay arbitration. *Sec. Ins. Co. v. Trustmark Ins. Co., 283 F. Supp. 2d 602, 2003 U.S. Dist. LEXIS 14777 (D. Conn., 2003)*

DISPOSITION: Affirmed.

COUNSEL: HARRY P. COHEN, Cadwalader, Wickersham & Taft LLP, New York, New York (Michael G. Dolan, Lawrence I. Brandes, on the brief) for Third-Party-Defendant-Appellant.

DAVID J. GRAIS, Dewey Ballantine LLP, New York, New York (Robert J. Morrow, on the brief, Kathryn C. Ellsworth, Brick M. Sandler, Shannon Elise McClure, of counsel, Frank F. Coulom, Jr., Marion B. Manzo, Robinson & Cole, LLP, Hartford, Connecticut, Mark B. Holton, Kathryn E. Nealon, Gibson Dunn & Crutcher LLP, New York, New York, on the brief), for Plaintiff-Appellee.

JUDGES: Before: OAKES, POOLER, AND WESLEY, Circuit Judges.

OPINIONBY: Wesley

OPINION: [*323] WESLEY, *Circuit Judge*:

This case presents a recurring and troubling theme in many commercial contracts: to what extent must a court confronted with a choice-of-law provision in a contract incorporate the designated state's statutory and common law governing arbitrations even when doing so seems contrary to the *Federal Arbitration Act* ("FAA")?

I. Background

TIG Insurance [**2] Company ("TIG") and Security Insurance Company of Hartford ("Security") entered into a contract ("Reinsurance Agreement") whereby Security agreed to reinsure a portion of TIG's liability for certain workers' compensation claims. The agreement was negotiated by Security's agent WEB Management LLC ("WEB"). The Reinsurance Agreement contains an arbitration clause in Article 27 submitting "any irreconcilable dispute between parties" to arbitration n1 and a choice-of-law clause in Article 28 that designates California's law as controlling. n2

n1 In full, the arbitration clause reads: "As a condition precedent to any right of action hereunder, any irreconcilable dispute between parties to this Agreement shall be submitted for decision to a board of arbitration composed of two arbitrators and an umpire meeting a place [sic] to be agreed by the board."

n2 In full, the governing clause states: "This Agreement shall be governed by and construed according to the laws of the state of California, except as to rules regarding credit for reinsurance in which case the rules of all applicable states shall pertain thereto. Notwithstanding the foregoing, in the event of a conflict between any provision of this Agreement and the laws of the domiciliary state of any company intended to be reinsured hereunder, that domiciliary state's laws shall prevail."

[**3]

[*324] At the time it entered into the Reinsurance Agreement with TIG, Security also entered into another contract ("Retrocession Agreement") with Trustmark Insurance Company ("Trustmark") whereby Trustmark agreed to reinsure Security for 100% of the risk that Security had assumed from TIG under the Reinsurance Agreement. WEB acted as agent for both Security and Trustmark with regard to the Retrocession Agreement. That agreement does not contain an arbitration clause.

Several years thereafter, Trustmark informed Security that TIG had defrauded WEB in connection with the Reinsurance Agreement and suggested Security rescind that agreement. Security requested Trustmark provide proof of the alleged fraud. Instead of providing the requested proof, Trustmark notified Security it was rescinding their agreement. Security filed a complaint against Trustmark in federal court seeking declarations that Trustmark was not entitled to rescind the Retrocession Agreement; that the agreement remained valid and binding, and that Trustmark was required to pay Security for all losses covered by the agreement. n3 Trustmark then filed a third-party complaint against TIG alleging TIG had fraudulently induced [**4] the Retrocession Agreement in an "attempt to transfer to its unsuspecting reinsurers[, Security and Trustmark,] tens of millions of dollars in losses stemming from its under-performing workers' compensation business."

n3 Security also included claims under the Connecticut *Unfair Insurance Practices Act*, the Connecticut *Unfair Trade Practices Act*, and the common law for bad faith.

A month prior to Trustmark's third-party complaint, Security suspended further claim payments to TIG based on Trustmark's allegations of fraud. In response, TIG invoked the arbitration clause in the TIG/Security Reinsurance Agreement. Security invited Trustmark to undertake the defense of TIG's claims against Security and further proposed resolving all of the issues pending in the lawsuit through arbitration. Security and Trustmark were unable to agree and the arbitration proceeded. As of this appeal, Security and TIG had selected the arbitrators and umpires, submitted positional statements to the arbitration panel, held an organizational [**5] hearing, and submitted proposed briefing and hearing schedules. Prior to the hearing, which was set to begin on August 11, 2003, however, Security moved before the arbitration panel to stay the arbitration pending the trial in the district court.

Thereafter, Security moved in district court to stay the arbitration pending completion of the court action. Security asserted that the choice-of-law provision in the Reinsurance Agreement reflects the intentions of TIG and Security to apply California's arbitration rules. Those rules include *California Civil Procedure Code § 1281.2(c)(4)*, which permits a court to stay a pending arbitration where one of the parties is also a party to a pending court action arising out of the same transaction and there is a possibility of conflicting rulings.

The district court granted Security's motion relying primarily on *Volt Information Sciences, Inc. v. Board of Trustees, 489 U.S. 468, 103 L. Ed. 2d 488, 109 S. Ct. 1248 (1989). See Sec. Ins. Co. of Hartford v. Trustmark Ins. Co., 283 F. Supp. 2d 602* [*325] *(D. Conn. 2003)*. The district court rejected TIG's argument that *Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 131 L. Ed. 2d 76, 115 S. Ct. 1212 (1995)*, [**6] required a different result. *See Sec. Ins. Co., 283 F. Supp. 2d at 606-07*. The court utilized California state law to determine whether the choice-of-law provision evidenced the parties' intent to incorporate California's arbitration rules. *See id. at 608-10*. Relying on a recent California Court of Appeals decision, the district court concluded that *section 1281.2(c)(4)* was applicable and stayed the pending arbitration between TIG and Security until the proceedings in the district court were completed. The district court also concluded that its ruling was not inconsistent with Second Circuit cases TIG had raised in opposition to the stay, noting those cases involved New York law. *See id. at 610-11*. The district court also held that Security's conduct in preparation for arbitration did not waive its right to seek the stay. *See id. at 611*.

TIG appeals and we now affirm the district court's order.

II. Discussion

Section 2 of the FAA ensures that courts enforce arbitration clauses incorporated in contracts involving interstate commerce, thereby "creating a body of federal substantive law of arbitrability, applicable [**7] to any arbitration agreement within the coverage of the Act." *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24, 74 L. Ed. 2d 765, 103 S. Ct. 927 (1983); see also 9 U.S.C. § 2*. The FAA requires that "questions of arbitrability . . . be addressed with a healthy regard for the federal policy favoring arbitration," and that "any doubts concerning the scope of arbitrable issues . . . be resolved in favor of arbitration." *Moses H. Cone, 460 U.S. at 24-25*. The federal policy favoring arbitration, however, does not change the long established principle that "arbitration 'is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'" *PaineWebber Inc. v.*

Bybyk, 81 F.3d 1193, 1198 (2d Cir. 1996) (quoting *AT&T Techs., Inc. v. Communications Workers of Am., 475 U.S. 643, 648, 89 L. Ed. 2d 648, 106 S. Ct. 1415 (1986)).* Rather, the FAA requires "arbitration proceed *in the manner provided for in [the parties'] agreement.*" *Volt, 489 U.S. at 475* (quoting *9 U.S.C. § 4*) (emphasis in original). In *Volt*, the Court [**8] made clear that "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." *Id. at 476.*

Security agrees that the Reinsurance Agreement falls within the scope of the FAA, but argues that by including the California choice-of-law provision, the parties' evidenced their intent to employ California arbitration rules. *Section 1281.2(c)* provides that if a "court determines that a party to [an] arbitration is also a party to litigation in a pending court action or special proceeding with a third party [arising out of the same transaction and there is a possibility of conflicting rulings on a common issue of law or fact], the court . . . (4) may stay arbitration pending the outcome of the court action or special proceeding." *Cal. Civ. Proc. Code § 1281.2(c).* Security contends that this section does not manifest a preference for lawsuits over arbitration, but is merely a procedural mechanism that dictates the order in which the two proceedings are to occur. It relies heavily on *Volt* and [**9] rightly so.

In *Volt*, the Supreme Court held that this specific provision is not preempted by the FAA "in a case where the parties have [*326] agreed that their arbitration agreement will be governed by the law of California." *Volt, 489 U.S. at 470.* Volt Information Sciences, Inc. ("Volt") and Leland Stanford Junior University ("Stanford") had entered into a contract providing that all disputes would "be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association then prevailing unless the parties mutually agreed . . . otherwise." *Id. at 470 n. 1.* The agreement also provided that it would "be governed by the law of the place where the Project was located," which under the facts of *Volt* was California. *Id. at 470.* When Stanford filed suit in federal court against Volt and several third parties, Volt moved to compel arbitration, leading Stanford to move to stay arbitration under *section 1281.2(c)(4). Id. at 470-71.* The California Court of Appeals affirmed the lower court's grant of the stay, recognizing that the contract was subject to the FAA but holding [**10] that, by specifying the contract would be governed by California law, the parties had incorporated California's arbitration rules into their agreement. Thus, the parties contractually had agreed that arbitration would be governed by *section 1281.2(c)(4)* allowing a court to stay the arbitration. The Supreme Court upheld the stay and the court's construction of the choice-of-law provision noting that federal policy favoring arbitration did not require a certain set of procedural rules, "even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward." *Id. at 479.*

In *Volt*, the parties were permitted to structure their arbitration procedures as they saw fit, including incorporating California law. Furthermore, the Supreme Court refused to review the California court's construction of the contract noting that "the interpretation of private contracts is ordinarily a question of state law." *Id. at 474; see also PaineWebber, 81 F.3d at 1198* ("In interpreting an arbitration agreement we apply the principles of state law that govern the formation of ordinary contracts."). *Volt* controls the present [**11] case. It compellingly tells us that *section 1281.2(c)(4)* is a procedural rule for arbitration and therefore is not preempted by the FAA. The only remaining question is whether the choice-of-law provision reveals the intention of TIG and Security to incorporate California's procedural arbitration rules - including *section 1281.2(c)(4)* - into the contract. The district court, following *Volt*'s instruction, looked to California law.

TIG argues that *Mastrobuono*, as well as Second Circuit precedent, has altered *Volt*'s directive with regard to analyzing choice-of-law clauses in contracts. TIG contends that those cases now require that as a matter of *federal* law, general choice-of-law clauses do not incorporate state rules that govern the allocation of authority between courts and arbitrators. While TIG may have correctly characterized *Mastrobuono*, the procedural provision in question here does not limit an arbitrator's authority. In *Mastrobuono*, the parties incorporated an arbitration clause in their contract requiring the arbitration proceedings be conducted in accordance with the rules of the National Association of Securities Dealers. Those rules allow arbitrators [**12] to award punitive damages. However, the contract also contained a choice-of-law provision stating the agreement would be "governed by the laws of the state of New York." *Mastrobuono, 514 U.S. at 59 n. 2.* In New York, the *Garrity* rule provides that the power to award punitive damages is limited to judicial tribunals and is not within an arbitrator's authority. *Id. at 55* [*327] (citing *Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976)).* Following arbitration and an award of punitive damages, respondents in *Mastrobuono* moved to vacate the award.

The Court recognized that "the choice-of-law clause introduces an ambiguity into an arbitration agreement that would otherwise allow punitive damages awards." *Id. at 62.* In an attempt to give effect to all of the provisions of the contract, the Supreme Court held that "the

best way to harmonize the choice-of-law provision with the arbitration provision is to read 'the laws of the State of New York' to encompass substantive principles that New York courts would apply, *but not to include special rules limiting the authority of arbitrators.*" *Id. at 63-64* (emphasis added). Following [**13] *Mastrobuono*, our circuit has held that a general "choice of law provision will not be construed to impose substantive restrictions on the parties' rights under the Federal Arbitration Act." *PaineWebber, 81 F.3d at 1202.* Similarly, this Court has rejected the argument that a general choice-of-law provision without more evidences the parties' intent "to incorporate New York decisional law on the allocation of powers between the court and the arbitrator." *Nat'l Union Fire Co. v. Belco Petroleum Corp., 88 F.3d 129, 134 (2d Cir. 1996); see also Shaw Group, Inc. v. Triplefine Int'l Corp., 322 F.3d 115, 123 (2d Cir. 2003).*

The Second Circuit cases dealt with New York not California law. But more importantly, these cases involved "substantive restrictions on the parties' rights under the Federal Arbitration Act," *PaineWebber, 81 F.3d at 1202*, or "special rules limiting the authority of arbitrators." *Mastrobuono, 514 U.S. at 64.* In cases where an ambiguity is introduced by the choice-of-law provision, federal policy favoring arbitration requires a specific reference to the restrictions on the parties' [**14] substantive rights or the arbitrator's powers to establish that the parties clearly intended to limit their rights under the FAA. The present case does not involve those types of restrictions. *Section 1281.2(c)(4)* gives the court the power to stay an arbitration; it does not limit the rights of the parties to arbitrate particular issues or the arbitrator's power to resolve the dispute. As *Volt* makes clear, *section 1281.2(c)(4)* is a "state procedural rule[]" that "determine[s] only the efficient order of proceedings" and does "not affect the enforceability of the arbitration agreement itself." *Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 688, 134 L. Ed. 2d 902, 116 S. Ct. 1652 (1996)* (citing *Volt, 489 U.S. at 478-79*). As the district court correctly held, *Volt* tells us that the FAA does not preempt *section 1281.2(c)(4)* and therefore, we return to the question previously raised - how does California law interpret the choice-of-law provision utilized in this contract.

The district court looked to the California state court decision in *Volt* as well as a more recent case, *Mount Diablo Medical Center v. Health Net of California, Inc., 101 Cal. App. 4th 711, 124 Cal. Rptr. 2d 607 (Cal. Ct. App. 2002),* [**15] to chart a course in this regard. n4 As noted above, in [*328] *Volt*, the California Court of Appeals interpreted a similar choice of law provision as evidencing an intent to include *section 1281.2(c)(4).* Unfortunately, we cannot rely on the Court of Appeals' decision in *Volt*: the California Supreme Court denied discretionary review in that case and ordered that the opinion not be published. Thus, under California law, that decision cannot be considered authoritative. *See* California Rule of Court 977.

n4 TIG correctly argues that, except in rare circumstances, we defer to the Ninth Circuit's "prediction of the course of [California] law on a question of first impression within [California]." *Factors Etc., Inc. v. Pro Arts, Inc., 652 F.2d 278, 283 (2d Cir. 1981).* TIG contends that the Ninth Circuit has indicated that California law would require that a choice-of-law clause would have to incorporate specifically California's procedural arbitration rules. *See Wolsey, Ltd. v. Foodmaker, Inc., 144 F.3d 1205 (9th Cir. 1998).* TIG's reliance on *Wolsey* is misplaced, however, because in that case the Ninth Circuit relied on its interpretation of *Mastrobuono* to conclude that the choice-of-law provision did not incorporate *section 1281.2(c)(4). See id., 144 F.3d at 1212.* The Ninth Circuit did not predict how the California Supreme Court would rule on the question of state law.

[**16]

In *Mount Diablo*, the contract in question included a broad choice-of-law clause that read: "The validity, construction, interpretation and enforcement of this Agreement shall be governed by the laws of the state of California." *Mount Diablo, 101 Cal. App. 4th at 716.* In determining the parties' intentions, the court observed that although the choice-of-law clause was "generic" because it did not mention arbitration, it was still "broad, unqualified and all-encompassing," *Id. at 722.* Thus, the choice-of-law provision was construed to incorporate California's procedural rules regarding arbitration including *section 1281.2(c)(4).*

The choice-of-law provision in the present case is similarly broad and all encompassing. We agree with the district court that the California Supreme Court would conclude it evidences the parties' intent to incorporate *section 1281.2(c)(4).* California abides by the general proposition that sophisticated commercial parties intend a generic choice-of-law clause to control the entire agreement. *See Nedlloyd Lines B.V. v. Superior Court, 3 Cal. 4th 459, 468-69, 11 Cal. Rptr. 2d 330, 834 P.2d 1148 (1992). Nedlloyd* involved language identical [**17] to the clause in the Reinsurance Agreement, except for the forum selected - Hong Kong. *Id. at 463.* In that case, the California Supreme Court reasoned that "the phrase 'governed by' is a broad one signifying a relationship of absolute direction, control, and restraint." *Id.*

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at 469. In addition, the choice-of-law provision in the present case includes an exception for "rules regarding credit for reinsurance in which case the rules of all applicable states shall pertain thereto." If the parties intended for only California substantive law to govern, they could easily have made their intentions clearer with a second exclusion for California's arbitration rules.

Finally, as the *Mount Diablo* court observed, "where the state arbitration provision is not inconsistent with the FAA policy of enforcing arbitration procedures chosen by the parties, choice-of-law clauses making no explicit reference to arbitration commonly have been interpreted to incorporate the state's law governing the enforcement of arbitration agreements." *Mount Diablo, 101 Cal. App. 4th at 725.* n5 The Supreme Court has examined the procedural rule in question here [**18] and found it consistent with the FAA's broad policy goals. *See Volt, 489 U.S. at 479.* We believe the district court was correct in determining that the California Supreme Court [*329] would rule that the choice-of-law provision did incorporate the state's procedural rules for arbitration. Thus, we affirm its holding.

n5 We do not accept TIG's argument that *Mount Diablo* is distinguishable because the choice-of-law clause included the phrase "enforcement." The court reasoned that the inclusion of this phrase helped the court discern the parties' intent to include *section 1281.2(c)(4)*, but contrary to TIG's argument, this was not the sole ground for the court's finding. *Mount Diablo, 101 Cal. App. 4th at 722-25.*

We also find TIG's waiver argument without merit. TIG claims Security's participation in the preliminary arbitration proceedings resulted in a waiver of its right to seek a stay of the arbitration pending the outcome of the related litigation. To support its argument, however, [**19] TIG cites only cases that stand for the principle that a party that engages in an arbitration hearing cannot then contest the right to arbitrate. *See, e.g., Opals on Ice Lingerie v. Body Lines Inc., 320 F.3d 362, 368 (2d Cir. 2003); ConnTech Dev. Co. v. Univ. of Conn. Educ. Props., Inc., 102 F.3d 677, 685 (2d Cir. 1996).* In this case, the arbitration hearing has not commenced. Furthermore, Security notified TIG and the arbitration panel early in the proceedings of the possibility that it would move to stay the arbitration while the litigation was pending. Thus, we affirm the district court's holding.

III. Conclusion

The district court's order of August 5, 2003, granting appellee's motion to stay the pending arbitration is hereby AFFIRMED.