IADC Committee Newsletter

# ALTERNATIVE DISPUTE RESOLUTION

*February 2014*

## IN THIS ISSUE

*IADC ADR Committee Chair Val Stieglitz of Nexsen Pruet reports on recent trends regarding state statutes restricting out-of-state arbitrations.*

# Update on State Statutes Restricting "Out-of-State" Arbitrations

## ABOUT THE AUTHOR

**Val Stieglitz** is Chair of the IADC Alternative Dispute Resolution Committee, and has previously served as Chair of the Business Litigation and Intellectual Property Committees. He is the coordinator of the Litigation Practice Group at Nexsen Pruet, LLC, where he practices in its Columbia, S.C., office. He has been recognized as a South Carolina Super Lawyer, in Best Lawyers in America, and the Legal Elite of the Midlands. He extends thanks to Rachael Anna, an Associate in Nexsen Pruet's Greenville, S.C. office, for her assistance with this newsletter. He can be reached at vstieglitz@nexsenpruet.com.

## ABOUT THE COMMITTEE

The Alternative Dispute Resolution Committee serves all members who use mediation and arbitration to resolve disputes, as well as those who have become mediators or arbitrators in their own practices. The Committee publishes newsletters and is developing as a global resource for our international members, corporate counsel and insurance executives, to offer expertise on negotiating and drafting alternative dispute resolution provisions and on the effective use of alternative forms of dispute resolution.

Learn more about the Committee at www.iadclaw.org. To contribute a newsletter article, contact:

**Matthew Todd Lowther**
**Vice Chair of Newsletters**
Balch & Bingham LLP
(205) 226-3422
tlowther@balch.com

Congress passed the Federal Arbitration Act (FAA) in 1925 to place arbitration agreements on the same footing as other contracts.[1] Under the FAA, an arbitration provision *"shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract*." 9 U.S.C.A. § 2. This simple idea has, of course, spawned considerable controversy and litigation, and the tension between the FAA and State laws continues to appear on many fronts.

One such front involves State laws that seek to control where an arbitration may be conducted; or, put another way, where a citizen of the State can be compelled to arbitrate. A number of States have passed statutes in this area. For example, California, Arizona, Virginia, North Carolina, Indiana, Florida, Louisiana, Minnesota, Montana, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, South Carolina, and Texas all have statutes that address where an arbitration may occur, and/or define as unenforceable any arbitration clause that requires a resident to arbitrate a dispute out-of-State. [2] Most of these statutes are in the construction realm. Some are limited to disputes involving contractors and/or subcontractors; others include disputes involving public works, and others refer to disputes involving improvements to real property. But the gist is the same – the State statute presses up against the trend in recent years of expanding the scope and preemptive reach of the FAA.

South Carolina has one of the broadest statutes of this nature. South Carolina's statue is in the general "venue" section of the Code, and states that *"[a] provision in an arbitration agreement that arbitration proceedings must be held outside [South Carolina] is not enforceable with respect to a cause of action, which, but for the arbitration agreement, is triable in the courts of this state*." S.C. Code Ann. § 15-7-120(B) (emphasis added.) Thus, the South Carolina statute is not confined to particular types of disputes or particular types of contracts – it purports to apply to any arbitration agreement.

The South Carolina statute – and the other State statutes cited herein – raise obvious FAA preemption issues.

Litigating the application or non-application of the restrictive South Carolina statute would bring into play a number of competing principles. The FAA case law finds preemption if the following conditions are satisfied: (1) the underlying contract involves interstate or foreign commerce; (2) the parties have not agreed that state arbitration law

[1] The principal purpose of the Federal Arbitration Act (FAA) is to ensure that private arbitration agreements are enforced according to their terms, 9 U.S.C.A. §§ 2-4; AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740 (2011), and to reverse the longstanding judicial hostility to arbitration agreements that had existed at English common law and had been adopted by American courts, by placing arbitration agreements on the same footing as other contracts, E.E.O.C. v. Waffle House, Inc., 122 S.Ct. 754 (2002). The FAA reflects the fundamental principle that arbitration is a matter of contract. Rent-A-Car, West, Inc. v. Jackson, 130 S.Ct. 2772 (2010); *see also,* Stolt-Nielsen S.A. v. AnimalFeeds International Corp., 130 S.Ct. 1758 (2010) (stating that the foundational FAA principle is that arbitration is a matter of consent).

[2] Arizona (Ariz. Rev. Stat. § 32-1129.05); California (Calfi. Civ. Proc. Code § 410.42); Illinois (815 ILCS 665/1 et. seq.); Indiana (Ind. Code § 32-28-3-17); Florida (Fla. Stat. § 47-.025); Louisiana (La. Rev. Stat. § 9:2779); Minnesota (Minn. Stat. § 337.10); Montana (Mont. Code § 28-2-2116); New York (N.Y. Gen. Bus. Law 35-E § 757); North Carolina (N.C. Gen. Stat. § 22B-2): Ohio (Ohio Rev. Code § 4113.62); Oregon (Or. Rev. Stat. § 701.640); Pennsylvania (73 P.S. 514); Rhode Island (R.I. Gen. Laws § 6-34.1-1); South Carolina (S.C. Code § 15-7-120); Tennessee (Tenn. Code § 66-11-208); Texas (Tex. Bus. & Com. Code § 35.52); Utah (Utah Code 13-8-3); Virginia (Va. Code § 8.01-262.1).

applies; and (3) no other federal statutory scheme shields the state anti-arbitration law from FAA preemption. [3] The U.S. Supreme Court has held that the term "involving commerce" as used in Section 2 of the FAA is the functional equivalent of the term "affecting commerce," and accordingly, is broadly construed so as to be coextensive with Congressional power to regulate under the commerce clause. U.S. Const. Art. I, § 8, cl. 3; 9 U.S.C.A. § 2; Citizens Bank v. Alafabco, Inc., 123 S.Ct. 2037, 156 L.Ed.2nd 46 (2003). The South Carolina Supreme Court concurs that "commerce" under the FAA is to be interpreted consistently with the Commerce Clause. Mathews v. Fluor Corp., 312 S.C. 404, 440 S.E.2d 880 (S.C. 1994); *see also,* Lackey v. Green Tree Financial Corp., 330 S.C. 388, 498 S.E.2d 898 (Ct. App. 1998).

There are some circumstances, though, where the FAA does not preempt State law. For example, South Carolina courts have held the FAA to be inapplicable in transactions involving solely intrastate commerce. 9 U.S.C.A. § 1 *et. seq.*, Bradley v. Brentwood Homes, Inc., 398 S.C. 447, 730 S.E.2d 312 (2012) (holding that arbitration provision in the agreement was not enforceable under the FAA because the transaction at issue involved intrastate commerce). Furthermore, if parties to a contract incorporate a State arbitration law by reference, that law may become part of their agreement and trump the FAA. Volt Info. Scis. Inc. v. Board of Trs., 109 S.Ct. 1248 (1989) (holding that FAA does not preempt State law where parties agreed in contract to abide by State rules of arbitration); Bradley v. Brentwood Homes, Inc., 398 S.C. 447, 730 S.E.2d 312 (2012); Zabinski v. Bright Acres Associates, 346 S.C. 580, 553 S.E.2d 110 (2001); North Augusta Associates Ltd. Partnership v. 1815 Exchange, Inc., 220 Ga.App. 790, 469 S.E.2d 759 (1996) (holding that where two parties agreed to abide by State arbitration rules, the FAA has no preemptive effect); *see also* Christopher R. Drahozal, *Federal Arbitration Act Preemption*, 79 INDIANA LAW JOURNAL 411-415 (2004).

However, in South Carolina, a general choice-of-law clause providing that State law governs the contract does not incorporate State arbitration law such as to preempt the FAA. Zabinski v. Bright Acres Associates, 346. S.C. 580, 553 S.E.2d 110 (2001) (finding that despite a governing law provision in the partnership agreement providing that the agreement be enforced under the laws of South Carolina, the FAA still preempts Section 15-48-10 of the South Carolina Uniform Arbitration Act).

In addition to prevailing over State laws that invalidate arbitration clauses, the FAA also preempts State legislation that places arbitration clauses on an "*unequal footing*" with other contracts. Preston v. Ferrer, 128 S.Ct. 978 (2008) (holding that State statutes prohibiting arbitration of specific types of claims are preempted by FAA); Doctor's Assocs. V. Casarotto, 116 S.Ct. 1652 (1996)

[3] The FAA preempts State law that prohibits the arbitration of a specific type of claim. 9 U.S.C.A. § 2; *see also,* AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740 (2011); Stolt-Nielsen S.A. v. Animal Feeds International Corp., 130 S.Ct. 1758 (2010) (holding that it is only when an arbitrator strays from interpretation and application of the agreement and effectively dispenses his own brand of industrial justice that his decision may be unenforceable under the FAA); Valden v. Discover Bank, 129 S.Ct. 1261 (2009) (holding that under the FAA, state courts as well as federal courts are obliged to honor and enforce agreements to arbitrate); Bradley v. Brentwood Homes, Inc., 398 S.C. 447, 730 (S.E.2d 312 (2012) (determining that the FAA is intended to ensure that arbitration will proceed in the event a State law would have preclusive effect on an otherwise valid arbitration agreement); Toler's Cove Homeowners Ass'n, Inc. v. Trident Const. Co, Inc., 355 S.C. 605, 586 S.E.2d 581 (2003) (holding that FAA will preempt any State law that completely invalidates parties' agreement to arbitrate); Tritech Elec., Inc. v. Frank M. Hall & Co., 343 S.C. 396, 540 S.E.2d 864 (Ct. App. 2000) (holding that FAA preempts South Carolina's arbitration law).

(finding that State statutes are preempted by the FAA if they invalidate arbitration agreements on grounds different than those that invalidate other contracts); Soil Remediation Co. v. Nu-Way Environmental, Inc., 323 S.C. 454, 476 S.E.2d 149 (1996) (holding that the FAA preempts § 15-48-10(a) because that section singles out arbitration agreements); Munoz v. Green Tree Financial Corp., 343 S.C. 531, 542 S.E.2d 360 (2001) (holding that FAA preempted Section 15-48-10 of the South Carolina Uniform Arbitration Act, requiring that an arbitration notice be "*typed in underlined capital letters, or rubber-stamped prominently, on* the *first page of the contract").*

Put another way, a Court may not treat arbitration as an inherently less beneficial form of dispute resolution. Lackey v. Green Tree Financial Corp., 330 S.C. 388, 498 S.E.2d 898 (Ct. App. 1998). When interpreting agreements within the scope of the FAA, Courts must defer to the Federal policy favoring arbitration and resolve ambiguities as to the scope of the arbitration clause in favor of arbitration. Carolina Care Plan, Inc. v. United HealthCare Services, Inc., 361 S.C. 544, 606 S.E.2d 752 (2004), reh'g denied, (Jan. 6, 2005); *see also,* TechnoSteel, LLC v. Beers Const. Co., 271 F.3d 151 (4th Cir. 2001) (holding that under the FAA, any doubts concerning scope of arbitrable issues should be resolved in favor of arbitration).

While the specific issue of whether the location-aspect of the restrictive South Carolina statute is preempted by the FAA has not been addressed in a reported decision, the principles discussed above suggest that the provision would have difficulty surviving a preemption argument.

As noted, many other States have enacted similar legislation to S.C. Code Ann. § 15-7-120(B). Some of these States' provisions require any dispute resolution mechanism, including arbitration, to be venued in-State, as long as the dispute arises out of an in-State transaction, regardless of the parties' State of residency (*e.g.* Arizona and Illinois). Other provisions only bar out-of-state arbitration venues when at least one of the parties has its home base in-State and the dispute arises out of an in-State transaction (*e.g.* California, Utah, and West Virginia). The FAA will preempt these provisions if a Court concludes that they conflict with the purpose of the FAA. For example, a Virginia District Court held that the FAA preempted the Virginia anti-arbitration statute in a case involving two non-Virginia companies. M.C. Const. Corp. v. Gray Co., 17 F. Supp. 2d 541 (W.D. Va. 1998). The Fifth Circuit found that the FAA preempted the Louisiana statute, and required that a dispute be arbitrated pursuant to a contract between a non-Louisiana corporation and a Louisiana corporation. OPE Int'l LP v. Chet Morrison Contractors, Inc., 258 F.3d 443 (5th Cir. 2001).

While these kinds of statutes remain on the books in many States, their viability must be questioned in light of the FAA preemption principles that continue to emerge in the case law.

# PAST COMMITTEE NEWSLETTERS

Visit the Committee's newsletter archive online at www.iadclaw.org to read other articles published by the Committee. Prior articles include:

JANUARY 2014
Lawyer-less Mediations: Will Apple and Samsung Start a New Trend?
Cynthia Arends

DECEMBER 2013
The Mediation Caucus: Where the Rubber Meets the Road
Bruce P. Merenstein and Carl J. Schaerf

NOVEMBER 2013
Challenges to Mediation Confidentiality - A Potential Briar Patch for Lawyers and Clients
Alan Freisleben

SEPTEMBER 2013
Arizona's Broad Interpretation of the "Effective Vindication" Theory
Debora Verdier

AUGUST 2013
Mind Your P's and Q's in Mediation
Eric Watt Wiechmann

JUNE 2013
You Thought Arbitration Was Confidential? A Practical Comparison of Confidentiality (Or Lack Thereof) in Major Arbitration Forums
Scott D. Marrs and Joseph W. Hance III

MAY 2013
Mediation-- A Litigator's Glance in the Rear-View Mirror
Alan Freisleben

MARCH 2013
How to Deliver on the Promises of Arbitration: Tips for an Efficient, Expeditious and Cost-Effective Resolution of Disputes
Annie Finn

One Consequence of the Landmark Decision of the Indian Supreme Court in Bharat Aluminium Co. v. Kaiser Aluminium Technical Service, Inc.: Arbitration Agreements with Indian Parties Should be Replaced by New Ones *(Joint Newsletter with the International Committee)*
Anton G. Maurer