

FEDERAL VERSUS STATE ARBITRATION LAWS:  
WHOSE LAW APPLIES AND WHY DOES IT MATTER?

By Anne M. Devens

When advising clients about the arbitration process, many practitioners discuss what are sometimes called the “hallmarks of arbitration.” For example, they may discuss the speed with which the client can have a final hearing, a limited discovery process that is supposed to be less expensive than litigation, and the ability to have an expert decide the dispute. One issue that practitioners may not be focused on, however, is the effect of applicable arbitration law. The drafter of a contract must understand the consequences of including a general choice-of-law provision in an agreement that comes within the purview of the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (“FAA”). Similarly, litigators must understand how such a provision impacts their clients’ litigation positions. The question of whose law applies, as between federal and state arbitration laws, should not be overlooked because a general choice-of-law provision is not sufficient – at least in the Fourth Circuit – to invoke a particular state’s arbitration law.

Differences between the FAA and a state arbitration statute, such as the Virginia Uniform Arbitration Act, §§ 8.01-581.01-016 (“VUAA”), can arise in several important areas including discovery, such as the ability to subpoena documents from witnesses prior to a hearing, and reviewability, *i.e.*, the bases upon which one can challenge an arbitrator’s decision. The purpose of this article is to point out some of those differences so that practitioners may better assess the ramifications of applicable law on the arbitration process.

1. Background of the FAA and the VUAA

Congress enacted the FAA to overcome courts' refusals to enforce agreements to arbitrate and to place arbitration agreements on equal footing with other contracts.<sup>1</sup> The FAA makes

---

<sup>1</sup> See Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 270 (1995).

enforceable all written arbitration provisions in contracts "evidencing a transaction involving commerce . . . ."2 "The FAA creates 'a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act.'"3 Thus, any arbitration agreement "involving commerce" is subject to the FAA, which applies in both federal and state courts.4

Because the limited purpose of the FAA is to place arbitration agreements on equal footing with other contracts, the FAA requires courts to apply state contract principles.5 Arbitration under the FAA is a matter of consent, not coercion, and parties are generally free to structure their agreements as they see fit.6 The United States Supreme Court has explained that "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to so submit."7 When deciding whether the parties have agreed to arbitrate a certain matter, courts apply ordinary state-law principles that govern the formation of contracts.8

---

2 9 U.S.C. § 2; Smith Barney, Inc. v. Critical Health Sys. of N.C., Inc., 212 F.3d 858, 860 (4<sup>th</sup> Cir. 2000).

3 Porter Hayden Co. v. Century Indemnity Co., 136 F.3d 380, 382, n.2 (4<sup>th</sup> Cir. 1998) (quoting Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983)).

4 9 U.S.C. § 2; see Allied-Bruce Terminix, 513 U.S. at 273-81 (discussing meaning of "involving commerce"); Hasco, Inc. v. Schuyler, Roche & Zwirner, 981 F. Supp. 445, 449 (S.D. W. Va. 1997), rev'd on other grounds, 1998 U.S. App. Lexis 23695 (4<sup>th</sup> Cir. Sep. 22, 1998).

5 Note, "An Unnecessary Choice of Law: Volt, Mastrobuono, and Federal Arbitration Preemption," 115 Harv. L. Rev. 2250 (2002).

6 Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 479 (1989).

7 AT&T Technologies, Inc. v. Communications Workers of America, 475 U.S. 643, 648 (1986) (quoting United Steelworkers v. Warrior & Gulf Navig. Co., 363 U.S. 574, 582 (1960)).

8 First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995); Arrants v. Buck, 130 F.3d 636, 640 (4<sup>th</sup> Cir. 1997); Amchem Prods., Inc. v. Newport News Circuit Court Asbestos Cases, 264 Va. 89, 97, 563 S.E.2d 739, 743 (2002) (issue is one for judicial determination to be decided as a matter of contract).

If a state's laws conflict with the purposes of the FAA, the doctrine of preemption will invalidate the state law.<sup>9</sup> In enacting the FAA, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.<sup>10</sup> "FAA preemption thus targets anti-arbitration state laws that apply without regard to the intent of the parties, and requires courts to construe contractual ambiguities in favor of arbitration."<sup>11</sup>

The preemption doctrine does not address the effect of a state law that favors arbitration or that is consistent with the FAA. Instead, fundamental contract principles, such as an unequivocal expression of contractual intent, will govern, at least in the Fourth Circuit. Virginia has adopted the VUAA, which, like the FAA, makes enforceable a written agreement to submit to arbitration any controversy arising between the parties. Like federal law, Virginia has a strong public policy in favor of arbitration and the validity of arbitration agreements.<sup>12</sup> Thus, Virginia arbitration law appears entirely consistent with the purposes of the FAA.

While the purposes of the two acts appear consistent, a court must nevertheless determine whether to apply federal or state arbitration law when the parties have included a general choice-of-law provision in their agreement that is subject to the FAA. Generally, the courts reason that such a provision is not sufficient to invoke state arbitration rules, even if the rules are consistent with the FAA.

---

<sup>9</sup> Southland Corp. v. Keating, 465 U.S. 1, 15-16 (1984).

<sup>10</sup> Id. at 10.

<sup>11</sup> Note at 2253; Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983).

<sup>12</sup> TM Delmara Power, L.L.C. v. NCP of Virginia, L.L.C., 263 Va. 116, 122, 557 S.E.2d 199, 202 (2002).

2. Practical Considerations Militate in Favor of Finding That a General Choice-of-Law Provision is Insufficient to Invoke State Arbitration Laws and Procedures

The Fourth Circuit in Porter Hayden Co. v. Century Indemnity Co.<sup>13</sup> considered this issue and

held that a general choice-of-law provision is insufficient to invoke state arbitration laws.<sup>14</sup>

Absent an unequivocal expression of the parties' intent to invoke state rather than federal

arbitration law, a general choice-of-law provision is read merely as specifying that state

substantive law be applied to resolve disputes arising out of the contractual relationship.<sup>15</sup> In

holding that federal law should be applied, the Fourth Circuit in Porter relied on the United

States Supreme Court's decision in Mastrobuono v. Shearson Lehman Hutton, Inc.<sup>16</sup> In

Mastrobuono, the contract's choice-of-law provision specified that the entire agreement would be

governed by New York law. The Supreme Court held that such a general choice-of-law

provision within an agreement containing an arbitration provision was meant merely to specify

what law to apply to disputes arising out of the contractual relationship.<sup>17</sup>

Some have criticized the holdings in Porter and Mastrobuono because they require courts to

apply the FAA even when otherwise applicable state law, such as laws relating to the power to

---

<sup>13</sup> 136 F.3d 380 (4<sup>th</sup> Cir. 1998). See also Gresham v. Norris, 304 F. Supp. 2d 795 (E.D. Va. 2004) (following Porter).

<sup>14</sup> See also Smith Barney, Inc. v. Critical Health Sys of N.C., Inc., 212 F.3d 858, 860-61 (4<sup>th</sup> Cir. 2000). Other federal circuits hold similarly. See Sovak v. Chugai Pharmaceutical Co., 280 F.3d 1266 (9<sup>th</sup> Cir.), cert. denied, 537 U.S. 825 (2002) (interpreting choice-of-law provision as simply supplying state substantive law and not the state rules for arbitration); Roadway Package Sys., Inc. v. Kayser, 257 F.3d 287, 289 (3d Cir.), cert. denied, 534 U.S. 1020 (2001) (holding that a general choice-of-law provision is insufficient to support a finding that contracting parties intended to opt out of the FAA's default regime).

<sup>15</sup> Porter, 136 F.3d at 383.

<sup>16</sup> 514 U.S. 52 (1995).

<sup>17</sup> Porter, 136 F.3d at 383, citing Mastrobuono, 514 U.S. at 60.

issue subpoenas prior to a hearing and reviewability, would not undermine the FAA's substantive policies.<sup>18</sup> However, any other rule would present significant practical problems.

First, arbitrators would be forced to guess which federal provisions apply and which state provisions apply. For example, assume that the parties have an agreement that “evidences a transaction involving commerce” and is thus within the purview of the FAA. Assume further that the parties have included a general choice-of-law provision, selecting Virginia law to govern their agreement. If a court has compelled arbitration pursuant to the FAA, how will the arbitrator (or the parties for that matter) determine which Virginia arbitration law provisions apply to the arbitration proceeding? The courts that have expressly considered the issue hold that absent evidence that the parties intended to invoke state arbitration law, federal arbitration law applies.<sup>19</sup> Such a rule is easy to apply and prevents arbitrators and courts from having to perform protracted analyses to determine whether parties have contracted out of the federal standards.<sup>20</sup>

---

<sup>18</sup> Note, 115 Harv. L. Rev. at 2261.

<sup>19</sup> See Porter, 136 F.3d at 383; Mastrobuono, 514 U.S. at 60.

<sup>20</sup> Roadway, 257 F.3d at 289, 297 (explaining that the default rule in Mastrobuono is “comparatively simple for arbitrators and district courts to apply”). For example, some have proposed that arbitrators or judges determine whether a state arbitration rule is substantive or procedural. See id., 257 F.3d at 299 (discussing concurring opinion). Others would have a court determine whether a state arbitration statute affects only a state's substantive rights and obligations, or whether it also affects the state's allocation of power between alternative tribunals. Wolsey, 144 F.3d at 1212. As the Roadway court pointed out, such protracted analyses will result in legal uncertainty and thus may also deter settlements.

Additionally, the rule preserves and facilitates the ability of parties to contract around federal default standards.<sup>21</sup> As one court pointed out, it is not difficult for the parties to provide in their contract that disputes shall be resolved by arbitration in accordance with a particular state's arbitration laws, such as the VUAA.<sup>22</sup> If the parties expressly state their intent that the VUAA applies, then under Porter Hayden and similar authority, a court must apply the VUAA as long as the VUAA does not conflict with the FAA.

Finally, the rule will minimize the frequency with which parties will be found to have opted out of the FAA's default regime.<sup>23</sup> Such a rule is consistent with the Supreme Court's admonition that FAA standards control in the absence of contractual intent to the contrary.<sup>24</sup> Parties who have not expressly considered the issue will not be found to have contracted around the FAA default standards if they simply insert a general choice-of-law provision in the arbitration agreement.

### 3. Situations In Which Differences Between State and Federal Arbitration Law May Be Important

---

Several differences between the FAA and VUAA help illustrate the importance of considering choice-of-law issues in the contract drafting stage or in litigation of agreements that fall under the FAA.

---

<sup>21</sup> Roadway, 257 F.3d at 297.

<sup>22</sup> Id. at 297.

<sup>23</sup> Id. at 296.

<sup>24</sup> Id. (citing Mastrobuono, 514 U.S. at 59).

a. Discovery

One difference between the FAA and the VUAA lies in the acts' discovery provisions, and more precisely, how those provisions are applied by Virginia federal and state courts. Section 7 of the FAA governs the subpoena powers of arbitrators and provides, in relevant part:

Arbitrators . . . may summon in writing any person to attend before them or any of them as a witness and in a proper case to bring with him or them any book, record, document, or paper which may be deemed material . . . .<sup>25</sup>

Despite this seemingly broad language, the Fourth Circuit has held that this provision does not authorize an arbitrator to subpoena third parties during *pre-hearing* discovery unless the party seeking discovery makes a showing of "special need."<sup>26</sup> The Fourth Circuit reasoned that "the FAA's subpoena authority is defined as the power of the arbitration panel to compel non-parties to *appear before them*; that is, to compel testimony by non-parties *at the arbitration hearing*."<sup>27</sup> The court explained that the phrase "appear before them" must mean at the arbitration hearing itself and further reasoned that by agreeing to arbitration, parties forego "procedural niceties" including full-blown discovery from each other and from third parties.<sup>28</sup> Thus, it appears reasonably certain that if parties are engaged in arbitration governed by the FAA, pre-hearing

---

<sup>25</sup> 9 U.S.C. § 7.

<sup>26</sup> Comsat Corp. v. National Science Found., 190 F.3d 269 (4<sup>th</sup> Cir. 1999). The Comsat court declined to define "special need," but stated that at minimum, a party must demonstrate that the information it seeks is otherwise unavailable. Id. at 276. See, e.g., In re Deiulementar Compagnia Di Navigazione S.p.A., 198 F.3d 473 (4<sup>th</sup> Cir. 1999) (permitting party to preserve evidence of condition of ship and finding "special need" where party showed that the ship was undergoing repairs and was soon scheduled to leave U.S. waters); Gresham, 304 F. Supp. 2d at 796-97.

<sup>27</sup> Id. at 275 (first emphasis added).

<sup>28</sup> Id. at 276.

discovery from non-parties in the Fourth Circuit is not available, unless a party can show "special need."<sup>29</sup>

But, is the same result true when the parties have selected state law to govern an agreement that is otherwise within the purview of the FAA? Contracting parties frequently include general choice-of-law provisions in their agreements, designating a particular state's law to govern their agreement. If arbitration is "a matter of consent, not coercion" and the parties have selected state law to govern their agreement, then the state arbitration law regarding arbitrators' subpoena powers should arguably govern, as long as there is no direct conflict that would warrant preemption by the FAA.

For example, the VUAA provides, in pertinent part:

The arbitrators may issue subpoenas for the attendance of witnesses and for the production of books, records, documents and other evidence, . . . .<sup>30</sup>

The language of this provision is silent as to whether the arbitrators' powers exist only for the hearing itself or if they exist for pre-hearing discovery. Additionally, unlike the subpoena provision in section 7 of the FAA, the phrase "appear before them" does not exist in the Virginia statute. Thus, the reasoning employed by the Fourth Circuit Court of Appeal in Comsat, *i.e.*, that the phrase "appear before them" must mean at the arbitration hearing, would not necessarily apply to the Virginia statute. No Virginia cases have addressed whether this provision of the VUAA can be used to compel pre-hearing discovery from third parties, even if an arbitration

---

<sup>29</sup> The federal circuits are split on this issue. Compare Hay Group Inc. v. E.B.S. Acquisition Corp., 360 F.3d 404 (3d Cir. 2004) (holding that the FAA does not empower arbitrators to issue subpoenas to nonparties for prehearing document production) with In the Matter of Arbitration Between Security Life Ins. Co., 228 F.3d 865, 870-71 (8<sup>th</sup> Cir. 2000) (arbitrators have the power to compel prehearing production of documents).

<sup>30</sup> Va. Code § 8.01-581.06.

agreement otherwise falls within the purview of the FAA. Absent authoritative Virginia case law, one could argue that the subpoena provision in the VUAA, unlike the judge-made limitation of the subpoena provision in the FAA, does not limit arbitrators' subpoena powers to the hearing itself. Moreover, the VUAA provision does not directly conflict with the FAA; nor is it inconsistent with the policies of the FAA.

However, applicable case law instructs that if the parties to an arbitration agreement that is otherwise subject to the FAA want Virginia arbitration provisions to govern, they must expressly state so. Although a practitioner who has only a general choice-of-law provision and who hopes to avoid the limitation on pre-hearing discovery under the FAA may argue that the VUAA subpoena provision applies instead of the FAA subpoena provision, the argument will fail.

b. Reviewability

Another difference between the FAA and the VUAA is in the acts' reviewability provisions. Under both federal and state law, the scope of review of arbitration awards is extremely narrow.<sup>31</sup> This is because "to allow full scrutiny of such awards would frustrate the purpose of having arbitration at all -- the quick resolution of disputes and the avoidance of the expense and delay associated with litigation."<sup>32</sup> Section 10 of the FAA provides the narrow statutory bases upon which parties may challenge an arbitrator's decision under federal law. The statute permits a federal court in the district in which the award was made to vacate the award in the following circumstances:

- (1) where the award was procured by corruption fraud, or undue means;

---

<sup>31</sup> Apex Plumbing Supply, Inc. v. U.S. Supply Co., 142 F.3d 188, 193 (4<sup>th</sup> Cir. 1998); see generally Signal Corp. v. Keane Fed. Sys., Inc., 265 Va. 38, 45, 574 S.E.2d 253, 256 (2003).

<sup>32</sup> Apex, 142 F.3d at 193.

- (2) where there was evident partiality or corruption in the arbitrators, or either of them;
- (3) where the arbitrators were guilty of misconduct . . . or in refusing to hear evidence pertinent and material . . . ; or of any other misbehavior by which the rights of any party have been prejudiced; or
- (4) where the arbitrators exceeded their powers . . . .<sup>33</sup>

In addition to these narrow statutory bases, federal courts may also vacate arbitral awards based on an arbitrator's "manifest disregard of the law." This judge-made vacatur basis, while rather ambiguous, is also narrow. "[N]either misinterpretation of a contract nor an error of law constitutes a ground upon which an award can be vacated."<sup>34</sup> Although this standard is narrow, it nevertheless represents another basis that is not enumerated in the FAA on which a party can challenge an award under the federal law.

In contrast, the Virginia Supreme Court has refused to approve a similar judge-made expansion of reviewability. The VUAA sets forth several statutory bases available to challenge an arbitration decision. These bases are similar to the statutory bases under federal law. Under Va. Code § 8.01-581.010, an award can be challenged for corruption, evident partiality, the arbitrator exceeding his power, and arbitrator misconduct.<sup>35</sup> However, unlike federal law, Virginia law expressly rejects the use of the ambiguous, judge-made standard "manifest disregard of the law."<sup>36</sup> The Virginia Supreme Court held that because the relevant Virginia arbitration statute

---

33 9 U.S.C. § 10.

34 Apex, 142 F.3d at 193-94 (citation omitted).

35 See Lackman v. Long & Foster Real Estate, Inc., 266 Va. 20, 580 S.E.2d 818 (2003).

36 Signal Corp., 265 Va. at 46, 574 S.E.2d at 257.

does not expressly contain the "manifest disregard of the law" standard, the court would not add that language to the statute:

Even though courts in other jurisdictions have vacated arbitration awards when there has been "manifest disregard of the law," we refuse to adopt that standard in this case because to do so would require that this Court add words to Code § 8.01-581.010, which enumerates the bases on which a court should vacate an arbitration award. Conspicuously missing from this statute is a provision that permits a court to vacate a judicial award when the arbitration panel has exhibited a "manifest disregard of the law."<sup>37</sup>

Consequently, a party's ability to challenge an arbitrator's decision under Virginia law is even more restricted than under federal law. However, Virginia law does not directly conflict with federal law. In fact, Virginia law regarding reviewability arguably furthers the policy underpinnings of the FAA because it does not allow parties to challenge an arbitral decision beyond the bases contained in the Virginia statute.

If the parties to an arbitration agreement that falls within the purview of the FAA include a Virginia general choice-of-law provision, will federal law or state law supply the available bases for review of the arbitral decision? Because the parties selected state law to govern their agreement and because the state arbitration law does not actually conflict with the FAA, one might argue that the state law should prevail. However, as previously explained, such a result presents numerous practical problems that militate in favor of relying on fundamental contract principles, such as an unequivocal expression of contractual intent, to determine applicable law.

---

<sup>37</sup> Id. at 46-47, 574 S.E.2d at 257-58.

#### 4. Conclusion

If parties to an arbitration agreement want to ensure that state arbitration rules will govern their agreement, they must expressly state so. A general choice-of-law provision is not sufficient to invoke a state's arbitration rules. Requiring the parties to articulate their intent is a logical and practical solution to the question of whose law should apply as between federal and state arbitration rules. Such a rule makes sense because it is easy to apply by arbitrators, judges and parties, and because it allows parties to readily contract around federal default standards should they want to rely on state arbitration rules. Moreover, the rule is consistent with the FAA's goals of enforcing arbitration agreements according to parties' agreements and placing arbitration agreements on equal footing with other contracts.

*About the Author: Anne M. Devens is a partner with Reed Smith LLP, in Falls Church, Virginia. She practices in the firm's business trials group and has experience in the areas of contracts, shareholder disputes, business torts, and patent disputes. Ms. Devens earned a B.S. from the University of Virginia and a J.D. from George Mason University School of Law. The opinions expressed are conveyed for educational purposes alone and not as specific legal advice.*