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Jay E. Grenig

Marquette University Law School, jay.grenig@marquette.edu

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Can you opt out of the Federal Arbitration Act by agreeing to abide by state arbitration laws?

by Jay E. Grenig

Volt Information Sciences Inc.

v.

Board of Trustees of Leland Stanford Junior University
(Docket No. 87-1318)

Argument Date: Nov. 30, 1988

While the Federal Arbitration Act clearly preempts state common law under which arbitration agreements are unenforceable, as well as state statutes that bar the enforcement of arbitration agreements, this case presents the issue of whether the parties to a contract can waive their rights under the Federal Arbitration Act and choose to have their rights to arbitration governed by state law.

ISSUE

The question before the court is whether a provision in a contract stating that it is to be governed by "the law of the place where the project is located" means that under California law the parties to the contract may be required to arbitrate only those disputes that do not involve third parties who are not bound by the arbitration agreement.

FACTS

Volt Information Sciences Inc. contracted with Stanford University to construct a system of electrical conduits throughout the Stanford campus. The contract included an agreement to arbitrate any disputes arising under the contract. The contract also provided that the contract was "governed by the law of the place where the project is located."

When a dispute developed regarding compensation for additional work, Volt submitted a claim that Stanford refused to pay. Volt then demanded that its claim be arbitrated. A week later Stanford filed suit in a California court, alleging fraud and breach of contract against Volt and two other companies with whom Stanford did not have arbitration agreements.

Volt petitioned the court to compel arbitration and to stay prosecution of Stanford's lawsuit. Relying on a California statute, Stanford responded with a motion to stay the arbitration on the ground that a lawsuit was pending involving defendants not bound by the arbitration agreement. The

court denied Volt's petition and granted Stanford's motion. The California Court of Appeal for the Sixth Appellate District upheld the trial court's order and the California Supreme Court denied review.

BACKGROUND AND SIGNIFICANCE

The Federal Arbitration Act applies to all commercial agreements involving interstate commerce. There is no provision in the Federal Arbitration Act corresponding to the California statute that allows a court to stay arbitration when third parties not subject to the contractual arbitration provision are involved in the dispute. Thus, if the Act is applicable, Volt's petition to compel arbitration would have to be granted.

The Federal Arbitration Act was intended to reverse centuries of judicial hostility to arbitration agreements and to ensure judicial enforcement of privately made agreements to arbitrate. The Act does not mandate the arbitration of all claims, but merely the enforcement of privately made arbitration agreements upon the motion of one of the parties.

If the parties had expressly stated in their contract that they wished to arbitrate only those disputes between themselves that did not involve third parties not bound by the arbitration agreement, presumably this provision would have been enforced.

What must be determined is whether the parties accomplished the same thing by choosing to be governed by California law.

Because the quoted words in the contract are from a standard choice of law provision contained in form contracts prepared by the American Institute of Architects, the Supreme Court's decision will have an impact on countless construction contracts throughout the United States.

If the Supreme Court holds that the Federal Arbitration Act overrides the state law provision allowing a court to stay arbitration when third parties not subject to arbitration are involved in this dispute, then the effect may be to force parties to arbitrate in situations where they may not have intended to arbitrate. This could result in conflicting rulings on common questions of law or fact where there is a pending court action involving parties not subject to the arbitration provision.

If, on the other hand, the Supreme Court should hold that the state law provision is applicable, this could encourage parties resisting arbitration in states having statutes similar to California's to file lawsuits against third parties who are not subject to the arbitration provision.

Jay E. Grenig is associate dean for academic affairs at Marquette University Law School, Milwaukee, WI; telephone (414) 224-5377.

ARGUMENTS

For Volt Information Sciences Inc. (Counsel of Record, James E. Harrington, Pettit & Martin, 101 California St., San Francisco, CA 94111; telephone (415) 434-4000)

1. The "place" where the project is located must be construed to encompass federal law as well as state law.
2. Even if the choice of law provision is taken to mean that California law governs, the supremacy clause of the U.S. Constitution operates to preempt California law because the contract is in interstate commerce.
3. The parties' choice of law, insofar as it results in direct conflict with federal law under the provisions of the Federal Arbitration Act, is rendered void and the federal rule prevails.

For Board of Trustees of Leland Stanford Junior University (Counsel of Record, David M. Heilbron, McCutcheon, Doyle, Brown & Enerson, 3 Embarcadero Center, San Francisco, CA 94111; telephone (415) 393-2000)

1. Enforcement of the arbitration agreement in accordance with the chosen California law does not create a conflict with the Federal Arbitration Act, as the purpose of the Act was to ensure that private agreements to arbitrate are enforceable.
2. Application of the Federal Arbitration Act in this case would force the parties to arbitrate in a manner contrary to their agreement.