No. 15-8

IN THE

Supreme Court of the United States

APPLIED UNDERWRITERS, INC., APPLIED UNDERWRITERS CAPTIVE RISK ASSURANCE COMPANY, INC. and CALIFORNIA INSURANCE COMPANY,
Petitioners,

v.

ARROW RECYCLING SOLUTIONS, INC. and ARROW ENVIRONMENTAL SOLUTIONS, INC.,
Respondents.

On Petition for a Writ of Certiorari to the California Court of Appeal, Second Appellate District

REPLY BRIEF FOR PETITIONERS

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Petitioners Applied Underwriters, Inc., California Insurance Company and Applied Underwriters Captive Risk Assurance Company, Inc. ("Petitioners") hereby submit their Reply to the Brief in Opposition of Respondents Arrow Recycling Solutions, Inc. and Arrow Environmental Solutions, Inc. ("Respondents"), as follows:

Either unwilling or unable to defend the ruling of the California Court of Appeal, openly hostile as it was to arbitration, Respondents instead invent a series of roadblocks. Their claims misstate the law and the record. There is no obstacle whatsoever that would prevent the Court from reviewing the issue of federal law that the Court of Appeal decided after receiving full briefing from the parties.

I. BECAUSE THE PARTIES ADDRESSED FAA PREEMPTION IN THE TRIAL COURT AND ON APPEAL, AND BECAUSE THE CALIFORNIA COURT OF APPEAL ACTUALLY RULED ON IT, THE COURT HAS JURISDICTION TO CONSIDER THE ISSUE.

Respondents' claim that the federal question raised by the Petition is raised there for the first time, see Brief in Opposition ("Opp."), at 2, is plainly false. Petitioners addressed the applicability of the Federal Arbitration Act, 9 U.S.C. §1, *et seq.* ("FAA ") in the trial court, at the Court of Appeal and again before the California Supreme Court. Accordingly whether Cal.

Civ. Pro. § 1281.2 was preempted by § 2 of the FAA is appropriately raised in the Petition.[1]

Petitioners moved to compel arbitration in the California trial court, arguing in part that the FAA applied. Respondents themselves acknowledged this, claiming that Petitioners "contend that the Federal Arbitration Act somehow preempts California law and mandates arbitration of the unfair Applied program." Opposition to Motion to Compel, dated August 14, 2012. Respondents then argued that the FAA did not preempt the application of California law. Similarly, the issue was raised in the Court of Appeal, where both sides fully briefed preemption and the Court of Appeal explicitly and thoroughly addressed the issue, see Pet. App.19a-21a, relying on this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford, Jr. Univ.*, 489 U.S. 468 (1989). And the Court of Appeal did not address the preemption arguments tangentially; rather, it fully aired the issue and ruled on it consistent with prior California Supreme Court precedent, in particular *Cronus Investments, Inc. v. Concierge Services*, 35 Cal. 4th 376 (2005). Petitioners then presented the issue to the California Supreme Court, which declined to take it up. Pet. App. 1a. The issue was thus squarely, and properly, presented in and decided by the rulings below of which Petitioners seek review.

The cases cited by Respondents do not support their jurisdictional claim. In each of those cases, the petitioner raised the federal issue for the first time

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[1] The October 13, 2013 and October 20, 2013 appellate briefs addressing FAA preemption of §1281.2 can be found on the electronic docket of the California Court of Appeal at: http://appellatecases.courtinfo.ca.gov/search/case/briefing.cfm?dist=2&doc_id=2031594&doc_no=B245379.

when petitioning this Court. For example, in *Cardinale v. Louisiana*, 394 U.S. 437, 438 (1969), the Court held that it would not "decide federal constitutional issues raised here *for the first time* on review of state court decisions." (Emphasis added.) The Court explained that:

> Questions not raised below are those on which the record is very likely to be inadequate, since it certainly was not compiled with those questions in mind. And in a federal system it is important that *state courts be given the first opportunity to consider the applicability of state statutes in light of constitutional challenge*, since the statutes may be construed in a way which saves their constitutionality.

Id. at 438 (emphasis added).

Cardinale, then, involved a federal question that had never been raised below, and over which the Court held that it lacked jurisdiction because the federal issues raised by the petitioner were *never* discussed, briefed or ruled on by any lower court. In that case, the petitioner's "admitted failure to raise the issue," plus "the failure of the state court to pass on this issue" and "the desirability of the giving the State the first opportunity to apply its statute on an adequate record," left the Court with no jurisdiction to consider the issue for the first time. *Id.* at 439.

Here, by contrast, the Court of Appeal received briefs fully addressing the issue and explicitly ruled on it. While the Court of Appeal did note that Petitioners had not addressed the issue in their opening brief on appeal, Pet. App. 18a, Petitioners did not do so because they had no reason to understand that §1281.2 had

been the basis for the denial of their request to compel arbitration given that the third party whose presence the trial court had relied on in barring arbitration had in fact agreed to arbitration. But when the Court of Appeal specifically asked for briefing on the application of § 1281.2, Petitioners argued preemption by the FAA, and the Court of Appeal elected to consider and address it even though it had not been raised initially. (The issue was also discussed at oral argument.) And when it decided the case the Court of Appeal engaged in a detailed analysis of *Volt* and *Cronus* and applied their holdings to the trial court's denial of Petitioner's arbitration motion. Pet. App. 19a-21a. Whether prompted by the Court or not, then, the issue was fully briefed, argued and decided below, and is thus properly presented herein.[2]

Even if this Court has concerns about the means in which the federal preemption of § 1281.2 was raised in the trial court or Court of Appeal, the fact that it was expressly addressed on appeal should satisfy them. As the Court has noted, the modern view is that a federal claim can be considered by the Court if it has either been raised in *or* addressed by the state court. See *Adams v. Robertson*, 520 U.S. 83, 86 (1997). Accordingly where (as here) a state court does address and resolve a federal question, it is immaterial whether

[2] For this reason, moreover, Respondents' citation to *Engle v. Isaac*, 456 U.S. 107 (1982), is also inapposite. In that case a criminal defendant in a state court case failed to raise his constitutional issue (a challenge to a jury instruction) at the time of his trial, causing the state appellate courts also to decline to take up the question. 456 U.S. at 115-16. By contrast, in this case the Court of Appeal received full briefing and argument and decided the FAA preemption issue, and the California Supreme Court was squarely presented with the issue but declined the opportunity to review it.

the question was properly raised in the state court proceedings. *Orr v. Orr*, 440 U.S. 268, 274–75 (1979); see also S. Shapiro, K. Geller, T. Bishop, E. Hartnett & D. Himmelfarb, *Supreme Court Practice* § 3.19, at p. 197 (10th ed. 2013) ("Once it is clear that the highest state court has actually passed on the federal question, any inquiry into how or when the question was raised in the state courts is considered irrelevant to the exercise of the Court's jurisdiction."). Here, it is beyond question, and is not disputed by Respondents, that the Court of Appeal addressed the federal preemption arguments. See Pet. App. 19a-21a.

Respondents also argue that the Court lacks jurisdiction to consider the applicability of Cal. Code Civ. Pro. § 1281.2 because it is "certainly not part of 'the Constitution, treaties, or laws of the United States.'" Opp. at 3. But whether § 1281.2 may be applied at all in light of § 2 of the FAA presents a distinctly federal issue of the sort appropriately (and frequently) addressed under 28 U.S.C. § 1257(a). Indeed, § 1257(a) directly confers on the Court jurisdiction "where the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States …." Petitioners have challenged the application of Cal. Code Civ. Pro. § 1281.2 in this case on the grounds that it is "repugnant" to § 2 of the FAA, an argument rejected by the California Court of Appeal.

II. WHETHER A GENERIC CHOICE OF LAW PROVISION THAT MAKES NO REFERENCE TO A PARTICULAR STATE'S LAW PERMITS A COURT TO APPLY A PROCEDURAL RULE OF THAT STATE TO DECLINE TO ENFORCE AN ARBITRATION CLAUSE PRESENTS AN ISSUE ON WHICH THE LOWER COURTS ARE IN DEEP DISAGREEMENT.

Respondents' claim that the FAA did not apply to the RPA because its generic choice of law provision only cited Nebraska law (Opp. at 5-7) would assume away the very point of this Petition. The question presented in the Petition is, precisely, whether such a generic choice of law provision, that is, one that specifies a contract's governing substantive law generally but does not specifically address arbitration *at all*, much less the FAA, should be read to displace the FAA's express federal preference for enforcing arbitration clauses. To argue, as Respondents do, that the FAA does not apply because it is not mentioned in the RPA's choice-of-law clause entirely begs the question whether the FAA has to be mentioned in a choice-of-law clause that does not specifically talk about arbitration. In this regard, though, it is worth noting, with some irony, that the RPA's choice-of-law clause did not mention the law of California either. Respondents nonetheless have no trouble arguing, and the California Court of Appeal had no trouble holding, that the RPA called for the application of a California procedural rule to bar enforcement of the arbitration clause in that agreement despite being no less silent about California law than it was about the FAA.

As Petitioners have demonstrated, a serious conflict among the lower courts exists on this issue. Petitioners cited a line of appellate cases from seven federal Circuits and five States which, applying *Mastrobuono v. Shearson Leahman Hutton, Inc.*, 514 U.S. 52 (1995), hold that a generic choice of law provision like the one in the RPA does not incorporate the chosen State's arbitration procedures, and thus that the FAA still applies (and preempts any contrary state law provision). See Pet. at 14-17. Under that line of cases, only when an arbitration provision or a choice-of-law clause expressly calls for the application of state arbitration procedures should courts dispense with the presumption of the applicability of the FAA. As Petitioners also explained, though, see Pet. at 18-22, courts that instead follow *Volt*, like state courts in California, hold that a generic choice of law provision should also be read as an agreement to negate application of the FAA, and to instead apply the law of the State referenced in the generic choice-of-law provision with respect to arbitration procedures (including the issue of arbitrability itself).

In their Brief in Opposition Respondents adopt the rationale in *Volt*, but they make no real case that the deep conflict among the lower courts described by Petitioners does not exist. But it is because of the differing rules followed in these respective jurisdictions that further guidance from the Court is needed. The way courts navigate the divide between *Volt* and *Mastrobuono* has become "a recurring and troubling theme in many commercial contracts." *Security Ins. Co. of Hartford v. TIG Ins. Co.*, 360 F.3d 322, 323 (2d Cir. 2004). The split in authority on this question is widely recognized, see, *e.g., Roadway Package Sys., Inc. v. Kayser*, 257 F.3d 287, 288 (3d Cir. 2001) (noting the "circuit-split[]" on "the conceptually complex issue

of how courts should determine whether parties have contracted out of the FAA's default rules"), and one federal judge has directly called on this Court to resolve it, see *id*. (Ambro, J., concurring) ("I would suggest [] that in light of the Circuit split on this issue, the Supreme Court may wish to clarify its holding in *Mastrobuono*."). The Court should use this case to take up that invitation.

Notably absent from Respondents' Brief in Opposition is any serious explanation of how the *Volt* line of cases can be reconciled with the *Mastrobuono* line of cases; rather, Respondents seem to suggest that, merely because both cases are on the books, they can necessarily coexist. The lower courts disagree, as does at least one member of the Court, see *Mastrobuono*, 514 U.S. at 64 (Thomas, J. dissenting) ("the choice-of-law provision here cannot reasonably be distinguished from the one in *Volt*").

III. THE RESULT THE COURT WILL REACH IN *DIRECTV, INC. V. IMBURGIA* WILL NECESSARILY INFORM THE ISSUE OF WHETHER THE CALIFORNIA COURTS WERE CORRECT IN BARRING ARBITRATION IN THIS CASE.

In opposing Petitioner's alternative suggestion that this case be held pending the ruling in *DIRECTV, Inc. v. Imburgia*, No. 14-462 (oral argument held October 6, 2015), Respondents double down on their claim that the RPA choice-of-law clause is not governed by the FAA—indeed, that it displaces the FAA—because it does not mention the FAA. As explained above, that argument begs the question presented in this case. And on that question the decision in *Imburgia* will no doubt shed light, especially on the interrelationship

between state contract law and the FAA. While the arbitration clause in *Imburgia* specified that it was governed by the FAA, the contract at issue also referred generically to the law of the State wherein the service was provided, that is, California, the law of which provided the basis for barring arbitration. In this case, though, while there was no express reference to the FAA in the RPA, there was no reference to California law anywhere in it either; nonetheless, and despite express reference to Nebraska law (albeit generically), a California statute was applied to bar arbitration, apparently for no other reason than that the underlying suit was filed there.

What the Court says in deciding *Imburgia*, and in particular how it defines the relationship between a generic reference to governing substantive law and the FAA's preference for enforcing arbitration clauses, will almost certainly inform the correctness of the Court of Appeal's ruling in this case. That the cases are "distinguishable" as Respondents argue (Opp. at 7) is an empty point. Indeed, this case is at least as striking an example of hostility to arbitration as was the lower court ruling in *Imburgia*, which came from the same division of the California Court of Appeal. While the contract at issue in *Imburgia* contained a reference to California law, on which the California state court relied in declining to apply the FAA, the RPA in this case did not contain any reference to California law at all.

How the Court rules in a case where California procedural law was applied despite the absence of any contract language calling for doing so will unquestionably illuminate whether it was permissible in this case to apply California procedural law despite the absence of *any* reference to California law, procedural

or otherwise. And certainly any resolution of *Imburgia* will require the Court to consider *Volt*, which case was much discussed at the oral argument on October 6.

The terms of the RPA have never been in real dispute. It contains a generic choice of law provision that, while it does not expressly call for the application of the FAA, says nothing about California, and in fact references, though generically, the law of another State. The Court of Appeal did not engage in any contract interpretation with regard to these provisions, but instead decided to apply a California statutory provision that is hostile to arbitration (allowing the Court to completely dispense with arbitration, unlike the provision in *Volt*, which only stayed arbitration proceedings) simply because Respondents chose to sue in California. This was contrary to the strong pro-arbitration aims of the FAA.

CONCLUSION

For the foregoing reasons, the Petition should be granted, or, in the alternative, held pending the Court's decision in *DIRECTV, Inc. v. Imburgia*, No. 14-462, and then remanded for reconsideration in light of that ruling.

Respectfully Submitted,

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