Application of Mandatory Law in U.S. Arbitration

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In this article, the authors examine claims under mandatory law and describe how they are treated in jurisdictions other than where they arise. They then analyze the effect of choice-of-law provisions on mandatory law. Finally, the authors explore how mandatory law may be treated by arbitrators.

A claim or defense under mandatory law is one that cannot be waived or otherwise circumvented by contract. Where parties agree to a general and broad arbitration clause, arbitrators are often confronted with claims or defenses under the law of a party's home jurisdiction where the parties' contract specifies a different legal regime.

The Supreme Court addressed the applicability of certain mandatory U.S. law in an international arbitration. In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*,[2] the Court compelled the parties to arbitrate in Japan defendant's counterclaims that alleged violations of the Sherman Act and Puerto Rico state law.[3] The arbitration agreement designated application of

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[2] 473 U.S. 614 (1985).

[3] The respondents in Mitsubishi were franchised car dealers and, while Mitsubishi is usually remembered as an antitrust case under the Sherman Act, respondents' counterclaims also included causes of action under the federal Automobile Dealers' Day in Court Act, 70 Stat. 1125, 15 U.S.C. § 1221 et seq.; the Puerto Rico competition statute, P.R.Laws Ann., Tit. 10, § 257 et seq. (1976); and the Puerto Rico Dealers' Contracts Act, P.R.Laws Ann., Tit. 10, § 278 et seq. (1976 and Supp. 1983).

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the rules and regulations of the Japan Commercial Arbitration Association, which contained a choice-of-law clause, stating: "This Agreement is made in, and will be governed by and construed in all respects according to the laws of the Swiss Confederation as if entirely performed therein."[4] Nonetheless, the Court held:

> Where the parties have agreed that the arbitral body is to decide a defined set of claims which includes, as in these cases, those arising from the application of American antitrust law, the tribunal therefore should be bound to decide that dispute in accord with the national law giving rise to the claim.[5]

The Court explained why the Sherman Act and Puerto Rico statutes constituted mandatory law:

> And so long as the prospective litigant effectively may vindicate its statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function. Having permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed.[6]

Because *Mitsubishi* arose from a motion to compel arbitration, rather than a confirmation of an award, its holding was forward-looking. The Court instructed the arbitrators to consider mandatory law claims to avoid the possibility that the award ultimately would be overturned for manifest disregard of law. As for the possibility that the arbitrators would read the choice-of-law clause as a waiver of a party's federal and state statutory claims, the Court noted that "we would have little hesitation in condemning the agreement as against public policy."[7] Therefore,

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[4] Id. at 637, n.19.

[5] Id. at 636-37.

[6] Id. at 637-38.

[7] Id. at 637, n.19.

under *Mitsubishi*, an arbitrator should not refrain from applying mandatory law in the face of a choice-of-law clause that ostensibly would prevent its application, at least in the international context.

The Court limited its holding to international arbitration.[8] This may explain why lower courts have not uniformly reached the same decision as *Mitsubishi* when adjudicating a mandatory law arising from a statute of different state than where the case is adjudicated. Federal courts have been confronted with requests to apply a variety of mandatory state laws, including local wage laws of Washington, D.C., that provide: "no provision of this chapter shall in any way be contravened or set aside by private agreement."[9] Employees subject to these District of Columbia statutory provisions have an unwaivable right to bring claims for unpaid wages and may take advantage of similarly mandatory damages provisions regardless of contractual choice-of-law or damages clauses.[10] Other claims under mandatory law include certain state law claims for unemployment insurance[11] and claims premised on the termination of franchise agreements without good cause.[12] Vast swaths of statutory claims in California are categorically unwaivable and, therefore, mandatory. In the words of the California state legislature, no "law established for a public reason [can] be contravened by a private agreement."[13] In New York, the legislature created a sort of hybrid mandatory law claim, whereby certain claims may be waived only after waiver agreements are approved by a workers' compensation board or similar body.[14]

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[8] Id. at 629.

[9] See, e.g., D.C. Code Ann. § 32-1305 (West).

[10] See, e.g., Id. at § 32-1308(a)(1)(A).

[11] See, e.g., N.Y. Labor Law § 595 (2008) (West) ("No agreement by an employee to waive his rights under this article shall be valid.").

[12] N.J. Stat. Ann. § 56:10-5 (West).

[13] Cal. Civ. Code § 3513 (West); see also Myriam Giles & Gary Friedman, Unwaivable: Public Enforcement Claims and Mandatory Arbitration, 89 Fordham L. Rev. 451 (2020).

[14] N.Y. Comp. Codes. R. & Regs. tit. 12, § 300.36 (N.Y.C.R.R.) (Providing that agreements to waive certain workers compensation claims "shall be reviewed by the chair, a designee of the chair, a member of the board, or a

Even though mandatory law is not waivable, claims and defenses under these laws generally are arbitrable where the arbitration agreement is general and broad.[15] Even in California, a state deemed by some to be hostile to arbitration, courts have devised a test to allow mandatory law disputes in arbitration, provided certain procedural requirements are met.[16] Other states typically are more laissez-faire, allowing arbitration of otherwise mandatory disputes such as those under state and local wage acts.[17] The Supreme Court has given its blessing to arbitrating mandatory statutory law on the theory that "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum."[18]

Workers' Compensation Law Judge, who will make a determination whether to approve or disapprove the agreement.").

[15] Assuming an arbitration clause is broad, it likely will be understood to cover all disputes between the parties relating to the relationship that is the subject of the contract. See Mitsubishi, 473 U.S. at 624, n.13 (statutory antitrust and unfair-competition claims); Gore v. Alltel Commc'ns LLC, 666 F.3d 1027, 1033 (7th Cir. 2012) (consumer fraud); Lozano v. AT&T Wireless Servs. Inc., 504 F.3d 718, 725-27 (9th Cir. 2007) (claims under Federal Communications Act); Highlands Wellmont Health Network Inc. v. John Deere Health Plan Inc., 350 F.3d 568, 576-78 (6th Cir. 2003) (fraudulent inducement).

[16] See Armendariz v. Found. Health Psychcare Servs. Inc., 24 Cal. 4th 83, 100, 6 P.3d 669, 680 (2000).

[17] See generally Dixon v. Perry & Slesnick P.C., 75 Mass. App. Ct. 271, 273, 914 N.E.2d 97, 99 (2009) (holding that even though claims under state Wage Act cannot be waived by private agreement, they can be arbitrated); Falls v. 1CI Inc., 208 Md. App. 643, 660, 57 A.3d 521, 531 (2012) (same).

[18] Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26, (1991) (quoting Mitsubishi, 473 U.S. at 628, 105 S. Ct. at 3354).

Attempts to Circumvent Statutory or Tort Disputes—Mandatory and Otherwise—Via Choice-of-Law Clauses

Case law suggests that choice-of-law provisions can complicate whether disputes under mandatory law should be heard by the arbitrators. Some courts have upheld the right to bring a mandatory law claim from a different jurisdiction or from the chosen law, while others have declined. Some have done this without any reasoning; but, to the extent some rationale can be discerned, it appears to depend on (1) the choice-of-law principles of the forum state, and (2) whether enforcement of the choice-of-law provision would deprive a party of the protection of any statute governing the conduct at issue.[19]

In *Johnson v. Diakon Logistics Inc.*,[20] the parties were subject to an employment agreement with a Virginia choice-of-law clause. The plaintiff sued in Illinois federal district court, alleging a series of contract claims as well as a claim under the Illinois Wage Payment and Collection Act (IWPCA),[21] which creates a statutory remedy for an employer's nonpayment or deduction of wages. The IWPCA is provides for certain non-waivable claims—albeit slightly unusual ones.[22] On summary judgment, the district court ruled that Virginia law applied and rejected the IWPCA claim.

The U.S. Court of Appeals for the Seventh Circuit reversed, holding that the employer could not escape the mandatory Illinois statutory claim, notwithstanding the contract's choice of Virginia law. Without directly invoking Illinois choice-of-law

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[19] This analysis is limited to state law. There is no question that parties may not exclude mandatory federal law through a choice-of-law clause. See Hayes v. Delbert Servs. Corp., 811 F.3d 666, 675 (4th Cir. 2016).

[20] 44 F.4th 1048, 1051 (7th Cir. 2022), reh'g denied, No. 21-2886, 2022 WL 4290757 (7th Cir. Sept. 16, 2022).

[21] 820 Ill. Comp. Stat. Ann. 115/2, 115/9.

[22] It is not the case that the IWPCA "cannot be waived;" rather, claims arising under the IWPCA "exist independently of and do not require interpretation of any [contract]." Byrne v. Hayes Beer Distrib. Co., 2018 IL App (1st) 172612, ¶ 32, 122 N.E.3d 753, 761.

principles—and relying instead on the unique independent-of-contract nature of the IWPCA—the Seventh Circuit noted that the IWPCA claims "arise from [an employee's] work in Illinois, not from their contracts ... [and so the IWCPA] governs payment for work in Illinois regardless of what state's law governs other aspects of the parties' relations."[23] While this reasoning was decisive, the Seventh Circuit was also persuaded by a broader, public policy concern: "[a] national firm such as Diakon" may not utilize "a single state's law to govern its labor force because it is simpler to learn and follow one state's rather than fifty states' laws."[24]

A similar concern animated a recent opinion in the U.S. District Court for the Southern District of New York. In *Yuille v. Uphold HQ Inc.*[25] Judge Lewis Liman declined to dismiss a Michigan Consumer Protection Act claim despite a broad New York choice-of-law clause.[26] Judge Liman observed that there was

> no binding authority addressing the question whether such a clause would prohibit the consumer from bringing a claim under a consumer protection statute, much less under circumstances where the effect of a Defendant's reading of the clause would be to deprive the consumer of the protection of any consumer protection statute.... Accordingly, Defendant's motion to dismiss Count III is denied without prejudice to renewal.[27]

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[24] Id.

[25] No. 22-CV-7453 (LJL), 2023 WL 5206888 (S.D.N.Y. Aug. 11, 2023).

[26] The choice-of-law clause provided: "You agree that the laws of the State of New York, without regard to principles of conflict of laws, govern these Terms and Conditions and any claim or dispute between you and us except to the extent governed by US federal law." Id. at *19 n.18.

[27] Id.

In other words, Judge Liman's concern was—like that of the Seventh Circuit—whether the choice-of-law clause effectively permitted the defendant to opt out of certain statutory tort claims, leaving plaintiffs across the nation with recourse either to only one state's or to no state's statutory protections.

The result in *Yuille* differed from three earlier New York federal cases. Two of these—both decisions out of the Southern District of New York—held that a New York choice-of-law clause, on its own and without recourse to choice-of-law principles, served as a categorical bar to the application of non–New York statutory claims (albeit not mandatory ones).[28]

A third case also dealt with a non–New York claim under non-mandatory law, but applied reasoning that seemingly would yield a different result if the non–New York statutory claim were mandatory. In *Canon U.S.A. Inc. v. Cavin's Bus. Sols. Inc.*,[29] the U.S. District Court for the Eastern District of New York applied New York's "interests analysis" whereby "New York courts may refuse to enforce a choice-of-law clause only where (1) the parties' choice has no reasonable basis, or (2) application of the chosen law would violate fundamental public policy of another jurisdiction with materially greater interests in the dispute."[30]

In *Canon*, the plaintiff was unable to point to any "authority in North Carolina, Nevada, or Florida identifying the enforcement of the [consumer protection statutes of each state] as a 'fundamental' public policy." The plaintiff also was unable to explain "how

[28] Off. Comm. of Unsecured Creditors v. Donaldson, Lufkin & Jenrette Sec. Corp., No. 00 CIV. 8688 (WHP), 2002 WL 362794, at *1 (S.D.N.Y. Mar. 6, 2002); Radiology & Imaging Specialists of Lakeland, P.A. v. FUJIFILM Med. Sys., U.S.A. Inc., No. 20 CIV. 4117 (AKH), 2021 WL 149027, at *5 (S.D.N.Y. Jan. 15, 2021). Notably, neither of these cases dealt with non–New York mandatory law and nothing in the reasoning of either decision provides any insight as to how the existence of a non–New York claim under mandatory law might affect or change the analysis.

[29] 208 F. Supp. 3d 494, 504 (E.D.N.Y. 2016).

[30] Id. (quoting Beatie and Osborn LLP v. Patriot Scientific Corp., 431 F. Supp. 2d 367, 378 (S.D.N.Y. 2006); but see N.Y. Gen. Oblig. Law § 5-1401 (McKinney) (allowing parties, in transactions of $250,000 or more to effectively choose New York law "whether or not such contract, agreement or undertaking bears a reasonable relation to this state.").

North Carolina, Nevada, and Florida have 'materially greater interests' than New York in this dispute."[31] Consequently, the *Canon* court enforced the parties' choice of New York law and dismissed the out of state statutory claims.

Notably, Illinois, the forum state in *Diakon*, applied the exact same "interest analysis" test when interpreting choice-of-law clauses:

> Illinois courts have adopted the Restatement (Second) of Conflict of Laws (1971) (the Restatement). Where a contract has expressly included a choice-of-law provision, section 187 of the Restatement applies. Under section 187, the parties' choice of law will govern unless (1) the chosen jurisdiction has no substantial relationship to the parties or the transaction, or (2) application of the chosen law would be contrary to the fundamental public policy of the jurisdiction with a materially greater interest in the disputed issue.[32]

Although the court in *Diakon* did not refer to an interest analysis, it likely informed the court's reasoning. *Diakon* effectively held that failure to apply the IWPCA claim would violate a fundamental public policy of Illinois, and that those mandatory law claims were enforceable notwithstanding the choice-of-law clause that caused the district court to dismiss the IWPCA claim.

Courts outside of the Seventh Circuit have read *Diakon* as having applied an interest analysis when determining if a chosen law should be applied.[33] Some jurisdictions do not subscribe to interest analysis which considers the fundamental public policy of other jurisdictions. In those jurisdictions that do not perform

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[31] Id.

[32] State Farm Mut. Auto. Ins. Co. v. Burke, 2016 IL App (2d) 150462, ¶ 61, 51 N.E.3d 1082, 1097.

[33] See, e.g., Buckmire v. LaserShip Inc., No. 120CV01493PTGIDD, 2023 WL 2010766, at *2 (E.D. Va. Feb. 9, 2023) (reading Diakon as being determined by recourse to application of the Restatement (Second) of Conflict of Laws under Illinois law).

an interest analysis, the outcome changes—even for mandatory law claims.

For example, in *Faltings v. Int'l Bus. Machines Corp.*,[34] a dispute arose between two parties to a franchise agreement involving franchisees who were based in New Jersey and planned to open their franchise in New Jersey. The parties selected New York law for all disputes arising out of the contract. One of the parties filed suit in Virginia alleging a claim under the New Jersey Franchise Practices Act, that required a franchisor to have "good cause" before terminating a franchise agreement.[35]

The U.S. Court of Appeals for the Fourth Circuit refused to look to New Jersey's "fundamental public policy" of limiting termination of franchise agreements to cases where good cause is found, because Virginia "has not generally adopted the Restatement (Second)'s flexible approach to choice-of-law analysis."[36] The *Faltings* court concluded that the New Jersey statutory claim should be dismissed, even though the underlying conduct giving rise to that statutory claim had occurred in New Jersey.

Summary of the Impact of Choice-of-Law Provisions on Out-of-State Mandatory Law

The muddiness of why mandatory law may not always be enforced can be traced, in part, to whether the forum court uses an interest analysis. The same facts can yield opposite results depending on the standard that the court applies. When:

1. Two parties agree on a choice-of-law clause,
2. The offending conduct arose in a state that has a mandatory law,

[34] 854 F.2d 1316 (Table) (4th Cir. 1988).

[35] Gen. Motors Corp. v. New A.C. Chevrolet, Inc., 263 F.3d 296, 319 (3d Cir. 2001) (holding that "[e]ven if the terms of a private franchise agreement permit termination at will, [the New Jersey Franchise Practices Act's] good cause requirement will supersede that arrangement and impose a good cause requirement on the franchisor's decision.

[36] Faltings, 854 F.2d at 1316.

3. The choice-of-law provision requires the application of the law of a different state than where the mandatory law claim arose, and
4. The lawsuit is commenced in a jurisdiction which does not apply interest analysis, then
5. The forum court may reject the mandatory state law claim of the law of a different state in favor of the state whose law was selected in the choice-of-law clause.[37]

Arbitrators Have Additional Considerations When Deciding Whether to Apply a Mandatory Law Claim

Claims or defenses that derive from the mandatory law of a different jurisdiction than the state whose law is designated require arbitrators to perform the same approach as judges. When the arbitration seat is located in a jurisdiction that rejects the interest analysis approach, a claim or defense arising under another state's mandatory law may be rejected. By contrast, when the seat embraces interest analysis, a mandatory law claim or defense from another jurisdiction may be upheld. It is reasonable for arbitrators to be guided by the same standards that govern the state where the arbitration is seated.

In addition to applying the same standards as courts, arbitrators face an additional obstacle before deciding whether to allow a claim under a law not provided for in the parties' contract. Arguably, the arbitration agreement both obligates the arbitrator to apply the law chosen by the parties and limits the arbitrator's authority to act contrary to the terms of the agreement. When the arbitration agreement contains a choice-of-law provision that directs an arbitrator to apply a specific state's law, arbitrators

[37] As Mitsubishi makes clear, arbitrators must apply a mandatory federal law of the United States even when the law of a foreign nation has been selected. Currently, some U.S. courts persist in declining to apply statutory claims of another U.S. state, even if they are mandatory in nature, when the forum state does not apply the interest analysis. This distinction between domestic and federal outcomes does not appear to have been raised or decided by the courts.

arguably exceed their powers if the apply a different law to decide the dispute.[38]

Arbitration is "a creature of contract."[39] Arbitrators must look to the contract (specifically, the arbitration clause) to determine the scope of their own jurisdiction.[40] This is a three-step process. First, the arbitrator must classify the arbitration clause as "broad" or "narrow."[41] Second, if reviewing a narrow clause, the arbitrators must determine whether the dispute is over an issue that "is on its face within the purview of the clause," or over a collateral issue that is somehow connected to the main agreement that contains the arbitration clause. Third, where the arbitration clause is broad, "there arises a presumption of arbitrability" and arbitration of even a collateral matter will be ordered if the claim alleged "implicates issues of contract construction or the parties' rights and obligations under it."[42]

One can imagine a situation, then, where two parties are subject to a contract that contains (1) a choice-of-law clause providing that any dispute arising from the parties' relationship shall be determined in accordance with the substantive law of New York without recourse to conflict of law principles, and (2) a broad arbitration clause pertaining to any and all claims arising out of or relating to the parties' relationship. The choice-of-law provision may give the arbitrator pause before permitting one of the parties to assert a claim under the New Jersey Franchise Practices Act on the theory that the agreement requires the arbitrator to hear claims solely under New York law.

When confronted with a similar fact pattern, the U.S. District Court for the Northern District of New York held that the arbitrator did not act in "manifest disregard of the law" by applying a mandatory Puerto Rico statute, notwithstanding a choice-of-law

[38] 9 U.S.C. § 10(a)(4).

[39] Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc., 252 F.3d 218, 224 (2d Cir. 2001).

[40] Id.

[41] The cases cited in this article all contained, a "broad" arbitration clause that could all claims arising out of the parties' relationship. See, e.g., Gilmer, 500 U.S. 20 at 35.

[42] Louis Dreyfus, 252 F.3d at 224.

provision that specified New York law. In *Conmed Corp. v. First Choice Prosthetic & Orthopedic Serv. Inc.*,[43] an arbitrator applied Puerto Rico law to a dispute involving a distribution contract to be performed in Puerto Rico. The provision governing choice-of-law mandated the application of New York state law the dispute. Claimant asserted that the choice-of-law provision was void under the Puerto Rico Dealer's Act, which provides:

> [D]ealer's contracts referred to in this chapter shall be interpreted pursuant to and ruled by the laws of the Commonwealth of Puerto Rico, and any other stipulation to the contrary shall be void. Any stipulation that obligates a dealer to adjust, arbitrate or litigate any controversy that comes up regarding his dealer's contract outside of Puerto Rico, or under foreign law or rule of law, shall be likewise considered as violating the public policy set forth by this chapter and is therefore null and void.[44]

The arbitrator reasoned: "Puerto Rico has a strong public policy that relates to the termination of Respondent's dealership," and thus that "the law of the Commonwealth of Puerto Rico should govern the Agreement."[45] In this respect, the arbitrator engaged in an interest analysis, even though he did not say that was what he was doing. Indeed, the arbitrator was correct because New York does not apply a generic choice-of-law clause to non-contractual claims.[46] The Northern District of New York upheld the award, finding that the arbitral decision did not involve any "a manifest disregard of the law."[47]

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[43] 651 F. Supp. 3d 605 (N.D.N.Y. 2023), reconsideration denied, No. 6:21-CV-1245 (BKS), 2023 WL 3647908 (N.D.N.Y. May 25, 2023).

[44] P.R. Laws Ann. Tit. 10.

[45] Conmed Corp. v. First Choice Prosthetic & Orthopedic Serv. Inc., No. 6:21-CV-1245 (BKS), Dkt. No. 1-5, at 2-5.

[46] See E*Trade Fin. Corp. v. Deutsche Bank AG, 420 F. Supp. 2d 273, 290 (S.D.N.Y. 2006); Knieriemen v. Bache Halsey Stuart Shields Inc., 74 A.D.2d 290, 293, 427 N.Y.S.2d 10, 13 (1st Dep't 1980).

[47] Conmed Corp. v. First Choice Prosthetic & Orthopedic Serv. Inc., 651 F. Supp. 3d 605, 625 (N.D.N.Y. 2023), reconsideration denied, No. 6:21-CV-1245 (BKS), 2023 WL 3647908 (N.D.N.Y. May 25, 2023).

Conclusion

Conmed does not illuminate the issue of whether choice-of-law provisions limit the authority of an arbitral tribunal to apply a state law that is different than the law selected by the parties in the arbitration agreement. Instead, the Northern District of New York merely left standing the arbitrator's ruling on the grounds that the award was not rendered in manifest disregard of law. The fact that *Conmed* award did not cite or rely on the implicit holding of *Mitsubishi* that the arbitral tribunal in Tokyo not only could, but must apply U.S. federal and state antitrust laws, however, suggests that the arbitrator in *Conmed* did not view *Mitsubishi* as binding authority for the proposition that a choice-of-law provision does not displace mandatory law.[48]

Nor does it seem likely that courts in the future will clarify how arbitrators should—or may—handle mandatory state law claims. Indeed, there is no reason to expect that courts will address an issue beyond what they are required to do when reviewing an arbitral award. The extremely deferential "manifest disregard of law" standard is not conducive to judicial pronouncements that an arbitrator's decision or reasoning was right or wrong.[49]

Absent clear judicial guidance, arbitrators will be left to discern for themselves whether to apply mandatory law claims that arise from statutes enacted in a state that is not designated in the choice-of-law clause.

[48] 473 U.S. at 637-38, 105 S. Ct. 3346, 3359.

[49] The manifest disregard standard is controversial and not applied in all federal circuits. See Restatement (Third) U.S. Law of Int'l Comm. Arb. § 4.20. Where arbitrators apply a different law than the one chosen by the parties to decide contractual claims, they arguably exceed their powers. See Affymax Inc. v. Ortho-McNeil-Janssen Pharm. Inc., 660 F.3d 281, 285 (7th Cir. 2011) (the arbitrator exceeded his powers when he appeared to have gone beyond "even trying to interpret Wisconsin law . . . but merely to have ignored it").