No. 18-175

In The
Supreme Court of the United States

APPLIED UNDERWRITERS, INC. ET AL.,
Petitioners,

v.

CITIZENS OF HUMANITY ET AL.,
Respondents.

On Petition For A Writ Of Certiorari To The Second Appellate District Court Of Appeal Of The State Of California

REPLY BRIEF OF PETITIONERS

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This Petition, like the petition in the companion case of *Applied Underwriters Captive Risk Assurance Co., Inc. v. Citizens of Humanity, LLC*,[1] presents two exceptionally important and recurring issues regarding the enforceability of arbitration agreements under the Federal Arbitration Act ("FAA") that have divided federal and state appellate courts.

On the first question, Respondents do not dispute that under FAA principles of contract interpretation, a general choice-of-law provision does *not* automatically import state rules evincing hostility to arbitration. Opp'n 13, 17. Instead, they argue that the McCarran-Ferguson Act renders the FAA inapplicable. But Respondents' invocation of McCarran-Ferguson is a red herring. That Act would allow Nebraska law to trump the FAA, *but only if the parties actually chose Nebraska law to govern the arbitrability of the contract in the first place.*

The parties here made no such choice. Under *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995), and *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983), the general choice-of-law provision in their contract did not incorporate Nebraska's anti-arbitration rule. McCarran-Ferguson is therefore entirely irrelevant to this case. Respondents' other arguments concerning the first question are equally baseless, and only underscore the absence of any legitimate basis to deny review. Petitioners unquestionably raised the

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[1] *See* Petition for a Writ of Certiorari, *Applied Underwriters Captive Risk Assurance Co. v. Citizens of Humanity*, No. 18-174 (Aug. 6, 2018) ("AUCRA Pet.").

Mastrobuono issue below, and there plainly *is* a split of authority on that issue. The question is both important and recurring, as the longstanding circuit split and this Court's decisions in this area highlight.

On the second question, Respondents try to deny the split of authority over the enforceability of arbitration delegation clauses. Opp'n 23–28. But Respondents completely ignore that the Nebraska Supreme Court in the companion case recognized a pronounced split of authority on this issue and explicitly aligned itself with the minority of courts on one side of the split. *See* Pet. 32–33. That conflict is real, and this Court should resolve it.

Finally, Respondents seek to avoid review by emphasizing that this case arises from state court. Opp'n 18–21. But Respondents concede that this Court's precedents squarely hold that the FAA applies in state court (Opp'n 20), and Respondents' suggestion that state court decisions are immune from review by this Court is therefore unfounded. In any event, Respondents are wrong to presume that Justice Thomas would not apply the governing principles from *Mastrobuono* and *Moses Cone* here.

In short, the decisions in these cases evince the very hostility to arbitration that the FAA was enacted to combat. This Court should either grant certiorari to review the important questions presented, or summarily reverse in light of *Mastrobuono* and *Moses Cone*.[2]

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[2] As Petitioners requested (Pet. 9 n.1), this Court should consolidate this Petition with the AUCRA Petition, No. 18-174, and grant or summarily reverse in both cases.

I. THE CHOICE-OF-LAW ISSUE WARRANTS REVIEW.

A. Ultimately, the question of arbitrability turns on the proper interpretation of the parties' contract. Here, because that contract unequivocally concerns "a transaction involving [interstate] commerce," 9 U.S.C. § 2, the interpretation of its arbitration provisions is subject to federal law and this Court's decisions in *Moses Cone* and *Mastrobuono*. In *Moses Cone*, the Court held that "questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration" embodied in the FAA. 460 U.S. at 24. The Court explained that "as a matter of federal law, any doubts" about the meaning of a contract must "be resolved in favor of arbitration"—including when "the problem at hand is the construction of the contract language." *Id.* at 24–25. In *Mastrobuono*, the Court reaffirmed this principle and further explained that a general choice-of-law clause "encompass[es] substantive principles that [the chosen state's] courts would apply, but not . . . special rules limiting the authority of arbitrators." 514 U.S. at 64. Respondents acknowledge this controlling principle. *See, e.g.*, Opp'n 17.[3]

Mastrobuono squarely governs this case. There, the Court refused—as a matter of contract interpretation—to apply a general New York choice-of-law provision that would have limited the authority of arbitrators. *See* 514 U.S. at 54–55, 64. In direct conflict with *Mastrobuono*, the California Court of

[3] Any doubt about whether that rule applies in state court is resolved by *Preston v. Ferrer*, 552 U.S. 346 (2008), which arose from the California state courts.

Appeal's holding here extended a general choice-of-law provision to incorporate a Nebraska anti-arbitration rule that bans arbitration altogether. The court did so even though the contract unambiguously establishes that the parties contemplated at least *some* disputes between them would be subject to arbitration (*e.g.*, by incorporating rules governing arbitration). *See* Pet. 10–11, 23. The California Court of Appeal's holding both flouts this Court's FAA jurisprudence and reaches a plainly absurd result.

Respondents have no response to *Mastrobuono*'s federal rule of interpretation. Instead, they point out that the Nebraska anti-arbitration statute prohibits arbitration of insurance contracts, and that McCarran-Ferguson allows the Nebraska statute to "reverse-preempt" the FAA. That argument rests entirely on the premise that the Nebraska anti-arbitration statute applies to the contract in the first place. *But whether the Nebraska law applies at all is the very question raised by the Petition*. Indeed, the Petition could not be clearer: the first question presented is "[w]hether a general choice-of-law clause should be read to incorporate . . . state arbitration principles . . . barring or otherwise evincing hostility to arbitration." Pet. i–ii.[4]

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[4] Respondents mischaracterize the first question presented as asking whether a general choice-of-law clause incorporates "state-law rules that are *inconsistent with the FAA*." Opp'n 13, 17 n.2, 16–18 (emphasis added). But that is not what the Petition says. Petitioners' actual question presented does not turn on (1) whether the state-law rule at issue is consistent with the FAA, but rather on (2) whether the state-law rule "evinc[es] hostility to arbitration." Pet. i–ii. McCarran-Ferguson is relevant to (1) but not to (2). Respondents' primary argument against certiorari—that the decision below "does not implicate"

Under *Mastrobuono*, the parties' general choice-of-law provision does not incorporate Nebraska's anti-arbitration statute into this contract at all. There is accordingly no basis for applying McCarran-Ferguson and concluding that the Nebraska statute bars application of the FAA. Because Nebraska's anti-arbitration statute is not incorporated at the threshold, McCarran-Ferguson simply is not implicated.

To the extent Respondents provide any defense of their question-begging, they point to the choice-of-law provision and assume it reflects a decision by the parties to apply Nebraska's anti-arbitration statute. *See* Opp'n 17 n.2 (asserting that "the petition offers no reason why a court should not revert to the law of the state chosen by the parties"). But, under this Court's decisions and the FAA, the choice-of-law provision does no such thing. As the Petition explained (at 10–11, 23), Nebraska's anti-arbitration rule would obliterate the parties' express contractual agreement to arbitrate disputes and render the arbitration provisions completely superfluous. That is obviously *not* what the parties intended—as the very existence of the arbitration clause makes clear. *See* Pet. 10–11, 23.

Indeed, the conflict between Nebraska's anti-arbitration rule and the contract's explicit embrace of arbitration is what triggers the *Moses Cone* principle of contract interpretation that resolves this case. Just as in *Mastrobuono*, federal law obligates the California courts to "harmonize the choice-of-law

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the question presented—arises only because Respondents attempt to redefine the question to trigger McCarran-Ferguson.

provision with the arbitration provision" by interpreting the former to encompass Nebraska law governing the "rights and duties of the parties" under the contract—but *not* Nebraska's "special rule[] limiting the authority of arbitrators." 514 U.S. at 63–64. The California Court of Appeal's contrary interpretation is directly at odds with *Mastrobuono*.

B. For the reasons discussed above, Respondents' reliance on McCarran-Ferguson is a red herring. Their other arguments against review are equally meritless.

First, Respondents seek to evade review by claiming that the *Mastrobuono* issue is not squarely presented. Opp'n 13–14, 18. But Petitioners expressly argued below that under *Mastrobuono* and the federal principles it embodies, the general choice-of-law provision did not incorporate Nebraska's anti-arbitration statute. *See, e.g.*, Appellants' Opening Brief at 38–40, *Citizens of Humanity, LLC v. Applied Underwriters, Inc.*, Case No. BC571913 (Cal. Ct. App. Jan. 25, 2017) ("While it is the case that the parties to the RPA agreed to a Nebraska choice of law provision, . . . a general choice of law provision does not also constitute an agreement to be governed by a state's specific arbitration act. . . . *[P]arties may agree to state substantive law for arbitration, but . . . the parties must clearly express their intent to be bound by a state's arbitration law*." (emphasis added) (citing *Mastrobuono*, 514 U.S. at 60–64)). Moreover, the California Court of Appeal explicitly recognized

that Petitioners had raised the issue, and the court expressly passed upon it. Pet. App. 18a–20a.[5]

Second, Respondents suggest that the indisputable split of authority (*see* Pet. 15–24) is unimportant because it is longstanding. Opp'n 19, 23. That argument makes no sense. Although the vast majority of courts to have weighed in on the issue have agreed with Petitioners, the California Court of Appeal's decision below—and the Nebraska Supreme Court's decision in the companion case—demonstrates that some courts refuse to reconcile themselves to *Mastrobuono*. Moreover, the longstanding and entrenched nature of the split weighs in *favor* of review, not against it. And, even if no split of authority existed on the *Mastrobuono* point (it does), this Court's action would be warranted because of the direct conflict with this Court's decisions on this fundamental arbitration principle.

Third, Respondents suggest that review is unnecessary because parties can simply draft around the problem caused by the decision below. Opp'n 23. But the *Mastrobuono* issue always arises when uncertainty exists over how to interpret a general choice-of-law provision, and this Court has never imposed a "clear statement" rule for enforcing an arbitration agreement. Such a rule would turn the FAA on its

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[5] Respondents also state (Opp'n 4) that, under Nebraska law, the parties may not "waive" the Nebraska anti-arbitration statute. This too is irrelevant unless the parties intended Nebraska law to govern this aspect of their contract, which they plainly did not. For the reasons discussed, such an interpretation is contrary to *Mastrobuono*, and thus no "waiver" issue arises. In any event, Respondents never raised this aspect of Nebraska law below, and this objection is itself waived.

head. Under *Mastrobuono*, the choice-of-law provision here does *not* incorporate Nebraska's anti-arbitration rule. Petitioners had every right to expect that California courts would properly apply *Mastrobuono*—and their failure to do so warrants this Court's corrective action.

Moreover, Respondents fail to acknowledge—let alone dispute—that the erroneous application of McCarran-Ferguson in this case has potentially broad implications for other jurisdictions. As explained (Pet. 29–30 n.4), at least 10 states have enacted laws barring arbitration in the insurance context. The decisions in these cases provide a roadmap for flouting the FAA and this Court's precedent regarding any arbitration contract containing a general choice-of-law provision pointing to those states' laws. Going forward, a party that expressly agrees to arbitrate certain disputes will try to evade that obligation by pointing to the choice-of-law provision and the decisions below and arguing that they require courts to countermand the parties' express contractual agreement to arbitrate. Respondents have nothing to say about that result, which threatens to upend arbitration.

C. One final point cannot be overemphasized. Respondents offer no response—*none whatsoever*—to the fact that their position renders the contract in this case (and many others like it) self-contradictory and senseless. Under Respondents' view, the detailed arbitration provision to which these sophisticated parties agreed was simply a nullity—a waste of language and paper. It is little wonder that Respondents completely ignore this obviously absurd interpretation of the parties' contract.

In short, the California Court of Appeal's refusal to follow this Court's decisions on this fundamental and recurring arbitration issue urgently requires the Court's intervention.

II. THE DELEGATION ISSUE WARRANTS REVIEW.

On the delegation issue, Respondents primarily seek to minimize the significance of the circuit split. But Respondents fail even to acknowledge that the Nebraska Supreme Court explicitly recognized a division of authority regarding whether *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (2010), applies to this particular agreement. *See* Pet. 32 ("A circuit split has arisen between the Third and Sixth Circuits and the Fourth Circuit . . . ." (quoting Nebraska Supreme Court)). That omission is conspicuous—and telling. And as Petitioners have explained (at 31–34), the Nebraska Supreme Court correctly diagnosed the split.[6]

As Petitioners have also explained (at 33–35), the delegation question is central to the scope of the FAA and the enforceability of arbitration agreements. Under the California Court of Appeal's decision (and

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[6] In a further attempt to prevent review, Respondents, after having split their original case into two (Pet. 9), state that Petitioners are not parties to the arbitration agreement. Opp'n 24 n.4. The court below did not rest its holdings upon this argument. *See* Pet. App. 24a. In any event, any issue on this score can be easily obviated by consolidating this case with the companion AUCRA Petition and granting in both, which would allow the Court to fully consider all issues in these companion cases.

the Nebraska Supreme Court's decision in the companion case), delegation clauses are rendered virtually meaningless: A party can avoid sending issues of arbitrability to an arbitrator simply by proclaiming that a challenge applies equally to the delegation clause and to the arbitration agreement as a whole. *See* Pet. 33–34. Such a legal regime would strip arbitrators of their authority on the all-important gateway issues and gut the entire operation of a delegation clause. But as this Court emphaemphasized in *Rent-A-Center*, parties have the right to specify that the arbitrator will resolve issues of arbitrability. 561 U.S. at 70.

This Court's review is accordingly warranted on the delegation issue as well.

III. STATE COURTS ARE NOT FREE TO DISREGARD THE FAA'S MANDATE.

Respondents also contend that the Court should deny review because this case arises from state court. Opp'n 18, 20. That argument defies existing law: As Respondents concede (Opp'n 20), this Court's precedent makes crystal-clear that the FAA and its principles of contract interpretation fully apply in state court. The California Court of Appeal, like any other court, is bound to apply that precedent, and failed to do so here. Respondents incorrectly imply that state courts should get a free pass to ignore this

Court's decisions. Indeed, the Court often reviews arbitration cases arising from state courts.[7]

Respondents also assert that review is unwarranted because Justice Thomas would refuse to apply *Mastrobuono* and relevant FAA principles to this case. But they are wrong to presume that too. Although Justice Thomas has taken the general position that Section 2 of the FAA does not preempt conflicting state arbitration laws in cases arising in state courts, he has nonetheless embraced *Moses Cone*'s requirement that—as a matter of federal law—courts must "construe ambiguities concerning the scope of arbitrability in favor of arbitration." *Mastrobuono*, 514 U.S. at 66 (Thomas, J., dissenting) (endorsing *Moses Cone* rule).

Indeed, Justice Thomas's dissent in *Mastrobuono* endorsed the Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), which explained that *Moses Cone*, among other cases, "establish[es] that, in applying general state-law principles of contract interpretation to the interpretation of an arbitration agreement . . . , due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself [must be] resolved in favor of arbitration." *Volt*, 489 U.S. at 475 (citation omitted). As *Volt* confirmed, that principle applies equally in federal or state court. *Id.* at 477 (applying *Moses Cone* principle to case arising from state court).

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[7] *See, e.g.*, *Kindred Nursing Ctrs. Ltd. P'ship v. Clark*, 137 S. Ct. 1421 (2017); *DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463 (2015); *Preston v. Ferrer*, 552 U.S. 346 (2008).

This case turns on the *Moses Cone* rule of contract interpretation, not on FAA preemption of contrary state law: Petitioners argue that the contract here must be construed in favor of arbitration, and therefore the contract's general choice-of-law provision does not trump its more specific provisions expressly embracing arbitration. That argument is entirely consistent with Justice Thomas's approach in *Mastrobuono*, which acknowledged both the *Moses Cone* rule and the rule that in contract interpretation, "the parties' intentions control." 514 U.S. at 66 (Thomas, J., dissenting). Both rules require that the same contract be interpreted the same way, regardless whether it is being interpreted in federal or state court.

In any event, the views of one Justice should not preclude review. Both *Mastrobuono* and *Preston v. Ferrer*, 552 U.S. 346 (2008)—which applied *Mastrobuono*—were decided by an 8-1 margin. There is no reason to believe this case would be any different.

This Court should not give state courts reason to think they may freely disregard the FAA, without any threat of review by this Court. Such disregard will continue unless this Court grants the Petition and makes the law concerning arbitration clear and unequivocal.

* * *

This case and the companion Nebraska case present ideal vehicles for reviewing two important arbitration issues and splits of authority. The decisions in these cases starkly reveal that—despite the dictates of the FAA and its pro-arbitration policy and

commands—lower courts continue to invent "new devices and formulas" manifesting "antagonism toward arbitration." *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1623 (2018). This Court's review is warranted to bring that trend to a halt.

CONCLUSION

The Petition should be granted.

Respectfully submitted,

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