

LEGAL PERSPECTIVE

THE SAME FEDERAL COURT THAT ENFORCED YOUR ARBITRATION CLAUSE MAY LACK JURISDICTION TO ENFORCE THE ARBITRATION AWARD

BY PETER NIGRA

Parties to commercial transactions, including specifically construction contracts, often elect to resolve disputes through arbitration rather than traditional litigation. Choosing arbitration can allow the parties to select favorable law, reduce the costs of litigation, and provide a level of certainty as to how disputes will be resolved. Owners and contractors are typically focused on the work itself rather than enforcing arbitration provisions and may assume that other parties will abide by the arbitration clause. But there are instances where a party will ignore an arbitration clause or rush to court in hopes of gaining an unfair advantage. When that happens, the opposing party may file a petition with a court to enforce the arbitration provision and force the dispute to be resolved as per the terms of the arbitration provision.

After deciding that court intervention is necessary to enforce an arbitration provision, the owner or contractor must then determine in which court they should file their petition to compel arbitration. It is likely that the opposing party improperly instituted litigation in a jurisdiction that is more favorable to their position. For example, a party may improperly file a complaint in Pennsylvania state court instead of abiding by the arbitration provision. The jurisdiction where the improper complaint was filed – Pennsylvania – may not be the most favorable jurisdiction to seek enforcement of the arbitration provision. Instead, a federal court may be more favorable. Therefore, one should not simply file a petition to enforce the arbitration provision in the same court in which the opposing party wrongfully instituted litigation but should instead consider all jurisdictional options.

Similarly, a party may need to seek court intervention to enforce, modify, or vacate an arbitration award after arbitration has concluded. Choosing whether to file a petition to enforce an arbitration award in state or federal court presents unique challenges. Even if a federal court had jurisdiction to enforce the arbitration provision in the first instance, that same federal court may lack jurisdiction to enforce a resulting award. That is, a party may appear before a federal judge at the outset of a dispute to enforce the arbitration clause. The federal judge may enforce the arbitration clause and direct that the parties resolve their dispute through arbitration as agreed in their contract. Following a successful arbitration, that same party may mistakenly believe that they can appear before the same federal judge to enforce the arbitration award. After all, if the federal judge had jurisdiction and authority to instruct the parties to go to arbitration, it is reasonable to believe that the same federal judge would have jurisdiction and authority to instruct the parties to abide by the resulting arbitration award. According to a recent decision by the Supreme Court of the United States, this is not necessarily the case.

This article will outline the different jurisdictional considerations that a party must evaluate when seeking to enforce an arbitration clause versus seeking to enforce an arbitration award.

Federal Courts Do Not Possess Inherent Jurisdiction to Enforce an Arbitration Clause Under the Federal Arbitration Act

In seeking to enforce an arbitration clause, parties typically rely on the Federal Arbitration Act (“FAA”), 9 U.S.C. § 1 et seq. The FAA provides that written arbitration agreements contained in a contract involving commerce are “valid, irrevocable, and enforceable”. FAA § 2. The FAA is presumed to apply to every arbitration agreement contained in a contract involving interstate commerce unless the arbitration provision expressly states the parties’ clear intent to apply state law in place of the FAA. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 62-64 (1995); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995). Even where the FAA is not mentioned in the contract, the FAA governs and preempts state law. *Id.* The FAA applies to any construction contract, even regional projects, so long as the contract “involves” interstate commerce. “Involving” interstate commerce is interpreted broadly. Even a contract as minimal as contracting with a multi-state business that utilizes materials which were supplied from another state may be sufficient. *Dobson*, 513 U.S. at 281. Therefore, unless your contract specifically and explicitly disclaims application of the FAA, it is very likely that the FAA will apply.

Even though the FAA is a federal statute, federal courts do not possess inherent jurisdiction to enforce arbitration clauses pursuant to the FAA. A party seeking to enforce an arbitration clause must demonstrate an independent jurisdictional basis to appear in the federal forum. Therefore, a party seeking to enforce an arbitration clause will need to understand jurisdictional standards and carefully evaluate their case to avoid unnecessary costs of an ineffective attempt to bring its petition before a federal court.

A federal court may only exercise jurisdiction over the enforceability of an arbitration clause pursuant to the FAA if the court would also have jurisdiction over the underlying substantive dispute. *Vaden v. Discover Bank*, 556 U.S. 49 (2009). This means that the actual dispute that was improperly filed in Pennsylvania state court must meet the criteria for federal jurisdiction as though the federal court could hear the entire case to verdict. Federal jurisdiction is established either by demonstrating that (1) the lawsuit arises under federal law; or (2) that the case has a value of more than \$75,000 and the parties have complete diversity of citizenship. 28 U.S.C. §§ 1331, 1332. If either of these criteria are met, the federal court will have jurisdiction to determine whether the arbitration clause is enforceable under the FAA.

How then, does the court determine whether it has jurisdiction to rule on a petition to compel arbitration under the FAA? According to the Supreme Court of the United States in *Vaden*, the federal court must evaluate the facts of the substantive dispute that have been set forth in the improper Pennsylvania state court pleadings. The federal court would consider, for example, whether the facts pled in the Pennsylvania state court pleadings demonstrate more than \$75,000 in potential damages and complete diversity of parties. This jurisdictional evaluation has been referred to as “look through” jurisdiction because the federal court must “look through” a petition to compel arbitration and into the underlying

state court pleadings in order to determine whether the federal court possesses subject matter jurisdiction. The party seeking to enforce the arbitration provision is not required to remove the Pennsylvania case to federal court before seeking enforcement of the arbitration clause under the FAA, but instead may ask the federal court to evaluate jurisdiction based on the Pennsylvania pleadings.

A party wishing to enforce its arbitration provision in federal court must understand “look through” jurisdiction and appreciate that the federal court will evaluate its jurisdiction by analyzing the state court pleadings. Depending on how the state court complaint has been pled, an attempt to compel arbitration in a federal court may not be possible.

A Petition to Enforce, Modify, or Vacate an Arbitration Award Must Plead Federal Jurisdiction on its Face

After successfully compelling arbitration and winning an arbitration award, the victorious party will want to enforce its arbitration award. Conversely, the losing party may wish to vacate the arbitration award. An attempt to enforce, modify, or vacate an arbitration award must be presented to a court possessing proper jurisdiction. Surprisingly, the jurisdictional standard to enforce an arbitration award is not the same as the “look through” jurisdictional approach applied to a petition to compel arbitration in the first instance. A party attempting to enforce its arbitration award at the close of the dispute may not be able to do so in the same court that compelled arbitration when the dispute was in its infancy.

According to the United States Supreme Court’s recent decision

in *Badgerow v. Walters*, (U.S. March 31, 2022), even if a party has demonstrated federal jurisdiction to compel arbitration under the FAA, that same party may be required to enforce the resulting award in a state court. Following *Vaden*, questions arose as to whether federal courts had jurisdiction over a petition seeking to enforce, modify, or vacate an existing arbitration award. Federal intermediate Circuit courts split on whether to apply the “look through” jurisdiction approach of *Vaden*, or to decline jurisdiction even where the underlying controversy would support federal jurisdiction. *Doscher v. Sea Port Grp. Secs., LLC*, 832 F.3d 372, 383 (2d Cir. 2016) (applying “look through” jurisdiction to petitions to vacate an arbitration award); *Goldman v. Citigroup Global Mkts., Inc.*, 834 F.3d 242 (3d Cir. 2016) (dismissing motion to vacate arbitration award for lack of jurisdiction, declining to apply “look through” jurisdiction, and holding that a federal district court may only exercise jurisdiction over a motion to vacate an arbitration award if the motion on its face supports federal subject matter jurisdiction).

In a March 31, 2022 opinion, the United States Supreme Court ruled that federal courts do not possess inherent authority to confirm, vacate, or modify an arbitration award and rejected the “look through” jurisdiction approach. *Badgerow v. Walters*, (U.S. March 31, 2022). Unlike a petition to compel arbitration, a petition to enforce, modify, or vacate an arbitration award must demonstrate federal jurisdiction on its face. Thus, a petition to enforce an arbitration award must allege facts supporting either diversity jurisdiction or federal question jurisdiction in order to be maintained in a federal court.

The party filing a petition to enforce an arbitration award must



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include facts which demonstrate that the parties have complete diversity of citizenship, and that the arbitration award has a value greater than \$75,000. The federal court will be unable to look at other pleadings. Following an arbitration award, federal jurisdiction must be re-evaluated, and the petition must be carefully pled. Relying on the fact that a federal court compelled the arbitration in the first instance is unadvisable.

Summary

The difference in jurisdictional approach may lead to seemingly strange results. For example, an opposing party, who is a citizen of Maryland, may improperly file a complaint in Pennsylvania state court despite having an arbitration clause in the contract. You, a citizen of Pennsylvania, may then petition the federal court in the United States District for the Western District of Pennsylvania to enforce the arbitration clause. The federal court would evaluate the underlying Pennsylvania state court complaint and your answer to the complaint to determine whether all parties are diverse, and the claim has a value in excess of \$75,000 – whether federal diversity jurisdiction exists. If so, the federal court may then enforce the arbitration clause and direct the parties to resolve the dispute as per the terms of the arbitration clause.

You then proceed to arbitration and win an award of \$60,000. The opposing party may refuse to abide by the award. In this instance, you would not be able to return to the federal court in the U.S. District for the Western District of Pennsylvania to enforce the award because your claim does not have a value in excess of \$75,000. You would need to go to Pennsylvania state court to enforce the arbitration award even though you first appeared in a federal court at the outset of this dispute.

Another scenario could be that the Pennsylvania state court complaint is filed against both you and a third party who, like your opposing party, is also a citizen of Maryland. You would not be able to maintain jurisdiction in federal court to enforce the arbitration clause because the underlying complaint does not have complete diversity of parties; both the opposing party and your co-defendant are Maryland citizens. Assume that you are successful in petitioning the Pennsylvania state court to compel arbitration and that during the arbitration the third-party from Maryland is dismissed and you win an award of \$80,000. You may now petition a federal court to enforce the arbitration award because diversity jurisdiction exists; there is no longer a second Maryland party in the case and the award is for greater than \$75,000.

Evaluation of federal subject matter jurisdiction differs depending on whether a party is seeking to compel arbitration at the outset of a dispute or to enforce an award at the conclusion. Navigating these pleading standards can be confusing, difficult, and, if not evaluated properly, needlessly expensive. Any party to a construction contract containing an arbitration provision should seek the advice of experienced counsel when faced with the decision of how to enforce an arbitration clause. Likewise, your counsel should undertake a detailed evaluation of the case following an arbitration decision to determine the proper venue to enforce, modify, or vacate an arbitration award.. 

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