Beware International Laws and Conventions

By Brian Gaudet

In the decision, *McDonnel Group, LLC v. Great Lakes Insurance SE, UK Branch*. No. 18-30817, 2019 WL 2082905, (5th Cir. May 13, 2019), the Fifth Circuit held that federal law favoring the enforceability of arbitration in international contracts pre-empts state law purporting to invalidate attempts to set jurisdiction or venue in another state. While the contract at issue in the case was an insurance policy, it is clear that the implications of this case are two-fold. First, this case directly affects potential insurance coverage disputes, a common fixture in construction defect litigation. Second, it also may affect other types of construction litigation. Many states have clauses that can nullify the effects of provisions in contracts requiring another state's laws to be applied, or venue in another state, when the issues in dispute are construction issues in the home state. Such clauses may render the provision void or voidable, depending upon a state's laws. When a party is dealing with an international construction related transaction (e.g., purchase of a piece of equipment from overseas), *McDonnel* holds that a party will not be able to use a similar state statute to overcome an arbitration clause.

In *McDonnel*, the contract at issue was a builder's risk insurance policy. The insurance policy contained a provision in which the policyholder agreed to arbitrate its disputes with the insurers. A claim was made, coverage was denied, and a lawsuit was filed in federal court by McDonnel against the insurers. The insurer's moved to dismiss the federal court action on the basis that the insurance policy contained an arbitration provision. McDonnel contended that the arbitration provision was "amended out" of the agreement by a provision in the policy that conformed the policy to applicable state law, thereby triggering the effect of another state law that nullified any arbitration clauses related to insurance policies covering property located in the state.

The court characterized the legal issue as one of preemption, federal law trumping state law. The federal law that the state law was up against was a commercial treaty adopted in the 50's. The court wrote, "In 1958, the United States joined and adopted the Convention, an international commercial treaty, to "encourage the recognition ... of commercial arbitration agreements in international contracts …" When the Convention is applicable, courts of signatory states must "at the request of one of the parties, refer the parties to arbitration, unless it finds that the ... agreement is null and void, inoperative or incapable of being performed." *Id*. at art. II(3). Because the Convention was an act of the executive branch and the Senate, the McCarran-Ferguson Act which nullifies any federal law affecting state laws related to the insurance industry derived from an "Act of Congress," was held not to apply.

The motion to dismiss was granted and the case was referred to arbitration.

The take-away is to beware of international laws and conventions when a construction project includes international components. Hometown advantage may be trumped by international laws adopted by the federal government.

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