Federal Court Enforces Arbitration Clause in Maritime Insurance Policy, Rejecting Reverse Preemption Claim

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The U.S. Court of Appeals for the Ninth Circuit has enforced an arbitration clause in a maritime insurance policy, finding the policy subject to the Federal Arbitration Act, and not "reverse preempted" by the McCarran-Ferguson Act. In so holding, the court determined that the policy's choice-of-law clause and arbitration provision controlled over somewhat different language in the application for the policy, because the latter did not qualify as a "contract." *Galilea, LLC v. AGCS Marine Insurance Co.*, 2018 WL 414108 (9th Cir. Jan. 16, 2018).

Two Montana residents, the Kittlers, established a Nevada LLC (Galilea), through which they purchased a yacht. Galilea submitted an insurance application for the yacht that contained arbitration and choice-of-law terms. The arbitration provision provided for AAA arbitration to take place in New York. The choice-of-law provision stated that the "relationship" and the "Agreement" would be governed by New York law. The insurance policy that eventually issued also contained choice-of-law and arbitration provisions, but with slightly different terms. Specifically, while the policy also called for AAA arbitration to take place in New York, the choice-of-law provision selected U.S. federal maritime law, with New York law to fill any gaps where maritime law did not provide any relevant precedent. Further, the policy provided that the scope of arbitrable disputes was "any and all disputes arising under this policy," rather than "any dispute arising out of or relating to the relationship [between the Kittlers and the insurance underwriters]," as stated in the application.

A month after the insurance policy issued, the Kittlers' yacht ran ashore. The underwriters declined to cover the resulting insurance claim, on the basis that the yacht had traveled south of the navigation limit in both the application and the policy. The underwriters commenced arbitration proceedings in New York, and Galilea filed objections and counterclaims. Galilea also filed a separate action in Montana federal district court, as well as a motion to stay the New York arbitration proceedings. The underwriters filed their own petition to compel arbitration in the U.S. District Court for the Southern District of New York.

The Montana federal district court issued two orders, providing that the arbitration provision in the application was irrelevant because it was not included in the underwriters' arbitration demand; the insurance policy was governed by federal maritime law; the Federal Arbitration Act (FAA) applied to the policy and required that the court enforce the policy's arbitration provisions; questions relating to enforceability and arbitrability were to be determined by the court, not an arbitrator; and the policy's

arbitration clause did not extend to ten of Galilea's twelve claims. Accordingly, the district court compelled arbitration as to two of Galilea's claims, but denied it as to the rest.

On appeal, the Ninth Circuit affirmed in part and reversed in part. The court generally found that the arbitration clause in the policy (not the one in the application) controlled, and was subject to federal law—both maritime law and the FAA. However, the court also found that the parties had agreed that questions of arbitrability would be decided by an arbitration panel and not by a court. Accordingly, the Ninth Circuit instructed the district court to grant the underwriters' motion to compel in its entirety, not just as to two of the claims.

With respect to which law controlled, the court found that the relevant document was the insurance policy itself, and not the application, because the application was not a contract. Noting that the FAA only applies where there exists an agreement to arbitrate, the court made a threshold determination as to whether there was such an agreement. The insurance application was not an agreement, the court held, because it contained no evidence of mutual assent to a contract or to arbitration. Under New York law—which the application called for in its choice-of-law provision—the application would only be deemed a part of the insurance contract if attached to the policy at the time of delivery. Because it was not, the application was not a contractual agreement under New York law, and federal law of arbitrability could not apply to the arbitration agreement it contained.

In contrast, however, the court determined that the insurance policy was in fact a contract subject to the FAA. The court noted that "[p]olicies that insure maritime interests against maritime risks are contracts subject to admiralty jurisdiction and to federal maritime law," citing the U.S. Supreme Court's decision in *Wilburn Boat Co. v. Fireman's Fund Insurance Co.*, 348 U.S. 310 (1955). The FAA specifically applies to "maritime transactions," *see* 9 U.S.C. § 2, thus requiring arbitration of the insurance dispute here. Galilea argued, however, that under federal maritime law, the FAA did not apply to the policy, because Montana public policy disfavoring arbitration "reverse preempted" the FAA pursuant to the McCarran-Ferguson Act.

The Ninth Circuit rejected Galilea's reverse preemption argument. As explained by the court, the McCarran-Ferguson Act, 15 U.S.C. § 1101 *et seq.*, allows state law to "trump" otherwise applicable federal if the state law regulates the business of insurance; the conflicting federal law does not; and the federal law would "invalidate, impair, or supersede" state insurance law. Galilea cited Montana's Uniform Arbitration Act, which bars enforcement of arbitration provisions in insurance policies, in support of its argument that Montana law reverse preempted the FAA under McCarran-Ferguson. The Ninth Circuit disagreed. Under *Wilburn Boat*, the court reasoned, a maritime insurance policy falls within federal admiralty jurisdiction and is governed by federal admiralty law (including the dictates of the FAA) in the first instance. State law, in contrast, is only relevant to maritime insurance contracts in the absence of a controlling federal rule. Because federal law is "primary" over state law with respect to maritime insurance contracts, the FAA's requirement of arbitration does not "invalidate, impair, or supersede" state law, particularly given the "interstitial, contingent" nature of state law in setting of a maritime insurance dispute. The same result would hold if a conflict-of-law analysis were done, since Montana law had virtually no relevance to this dispute (other than that the Kittlers happened to reside there), and since landlocked Montana has relatively little interest in maritime insurance disputes.

The Ninth Circuit also rejected Galilea's secondary argument that the policy's choice-of-law provision was unenforceable under *M/S Bremen v. Zapata Off-Shore Co.*, (*The Bremen*), 401 U.S. 1 (1972). *The Bremen* holds that forum selection clauses are presumptively unenforceable under federal maritime law, where they "would contravene a strong public policy of the forum in which the suit is brought." The court noted, however, that the dispute at issue was about a choice-of-law provision, not a forum selection clause. Further, the court observed that *The Bremen* dealt with conflicts between U.S. law

and the law of other nations, which were subject to international comity. In contrast, this dispute involved "an unequal, hierarchical relationship between federal maritime law and state law." Accordingly, there was no basis for Montana law to supplant federal maritime law, including the FAA.

Finally, the court determined that the parties had agreed to reserve the issue of arbitrability for an arbitrator by incorporating AAA rules into the insurance contract. The court noted that arbitrability is an "arcane" issue, and that the general presumption is *against* having it decided by an arbitration panel absent "clear and unmistakable evidence" that the parties wished to do so. Ninth Circuit precedent holds, however, that a contract between sophisticated parties that incorporates AAA rules qualifies as such evidence. AAA Commercial Arbitration Rule 7 specifically provides that "the arbitrator shall have power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope or validity of the arbitration agreement or to the arbitrability of any claim or counterclaim." The court concluded that the parties to the dispute—insurance companies, and two individuals, one of whom owned and operated a financial services company, who had formed an LLC to control a yacht worth more than a million dollars—were indisputably "sophisticated" and capable of agreeing to AAA rules.

Despite dealing with some complex arbitration law issues, *Galilea* applies two straightforward principles. First, the Ninth Circuit views insurance contracts for vessels to be maritime in nature, and thus governed by federal maritime law, including the FAA. Second, "sophisticated" parties can contract around the presumption against "arbitration of arbitrability" by agreeing to arbitration under AAA rules. As was the case in *Galilea*, when a maritime insurance policy is at issue, a state law disfavoring arbitration will not limit the FAA's broad reach.