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Supreme Court Stays Active in the Arbitration Arena

JOHN R. SNYDER

Financial industry firms with an interest in seeing arbitration remain viable as a means of individualized dispute resolution should make their voices heard in the regulatory reviews of arbitration and in any subsequent rulemaking process, the author suggests.

The U.S. Supreme Court continues to be active in arbitration cases. In the last few months, it has:

- Granted *certiorari* to consider another case involving the validity of class action waivers in arbitration clauses, following on the heels of its 2011 *AT&T Mobility v. Concepcion* decision.
- Granted *certiorari* to consider another case presenting the issue whether a party to a broad arbitration clause may be compelled to participate in class arbitration, following on its 2010 *Stolt-Nielsen* decision.
- Slapped down yet another state appellate court for giving state law precedence over the Federal Arbitration Act ("FAA").

The Court is well along in establishing itself as a friend of arbitration and of the FAA. The two cases to be heard and decided in 2013 could provide opportunities for the Court to reinforce that reputation. In the meantime, the Consumer Financial Protection Bureau ("CFPB") and the Securities and Exchange Commission have embarked on their Dodd-Frank Act-mandated

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reviews of pre-dispute arbitration clauses, either or both of which could result in regulatory counterweight to the Supreme Court's recent and anticipated arbitration pronouncements.

CLASS ACTION WAIVERS REDUX: *AMERICAN EXPRESS MERCHANTS* LITIGATION

The *American Express Merchants* case[1] puts before the Court the "vindication of statutory rights" theory for challenging arbitration agreements. That theory, purportedly part of the federal substantive law of arbitrability, traces its genesis to dicta in the Court's *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.* decision.[2] The issue the Court is to consider arises from its 2011 *AT&T Mobility LLC v. Concepcion* decision,[3] in which it struck down as contrary to the FAA a California Supreme Court common law rule deeming arbitration provisions that prohibit classwide proceedings to be unconscionable and therefore unenforceable in certain circumstances (the so-called "*Discover Bank* rule").

Amex III marks the third time the Second Circuit, invoking vindication of federal statutory rights analysis, has declared unenforceable the class action waivers in American Express's agreements with participating merchants.[4] In *Amex III* the Second Circuit held that *Concepcion* did not require a different result because, it found, the *Concepcion* decision did not "require that all class-action waivers be deemed per se enforceable." The Court observed that "[t]he fact that plaintiffs so often fail in their attempts to overturn such waivers demonstrates that the evidentiary record necessary to avoid a class-action arbitration waiver is not easily assembled."[5] Nevertheless the Court held that the Amex Merchants plaintiffs had succeeded in doing so, finding that "[t]he evidence presented by plaintiffs here [including an expert's affidavit] establishes, as a matter of law, that the cost of plaintiffs' individually arbitrating their dispute with Amex would be prohibitive, effectively depriving plaintiffs of the statutory protections of the antitrust laws."[6]

The Third, Fourth, Fifth, Seventh and Tenth Circuits—pre-*Concepcion*—have entertained the possibility that, given sufficient proof, the vindication of federal statutory rights theory is a viable means to avoid an arbitration agreement.[7]

CLASS ARBITRATION REDUX: *SUTTER V. OXFORD HEALTH PLANS*

In *Stolt-Nielsen v. AnimalFeeds International Corp*.,[8] an arbitration panel had determined that an arbitration clause allowed for class arbitration. The parties stipulated the arbitration clause was silent on the issue of class arbitration. Acting on the principle that an arbitrator lacks the power to order class arbitration unless there is a contractual basis for concluding the parties have agreed to that procedure, the Supreme Court in effect reinstated the district court's order vacating the arbitration panel's order allowing class arbitration.[9] Significantly, the Court observed that "class-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their disputes to arbitration."[10]

The Supreme Court has now taken a case in which, although the arbitration clause at issue does not mention class arbitration, there is no stipulation by the parties as to the arbitration clause's silence on class arbitration. The question presented in the *certiorari* petition in *Oxford Health Plans LLC v. Sutter* is, "Whether an arbitrator acts within his powers under the [FAA]… or exceeds those powers…by determining that parties affirmatively 'agreed to authorize class arbitration'…based solely on their use of broad contractual language precluding litigation and requiring arbitration of any dispute arising under their contract."

In *Sutter*, an arbitrator construed such a broad arbitration clause to authorize class arbitration. The Third Circuit affirmed a district court's denial of a motion to vacate the arbitrator's decision.[11] The Third Circuit distinguished *Stolt-Nielsen* on the basis that, unlike in *Stolt-Nielsen*, "[n]o stipulation between Oxford and Sutter is conclusive of the parties' intent" as to class arbitration.[12] The Third Circuit's decision is to a great extent based on the limited scope of "exceeded their powers" review afforded arbitration decisions under the FAA.[13]

The Second Circuit previously ruled on this issue consistent with the Third Circuit's reasoning;[14] the Fifth Circuit has come out the other way.[15]

ANOTHER ERRANT STATE APPELLATE COURT SET STRAIGHT: *NITRO-LIFT TECHNOLOGIES*

Early last year it was the West Virginia Supreme Court receiving a Supreme Court rebuke on the subject of FAA supremacy.[16] In late 2011 it was

a Florida appellate court.[17] Most recently it was Oklahoma's turn.[18] As on the two previous occasions, the Supreme Court spoke summarily, through a *per curiam* decision on a *certiorari* petition, vacating the Oklahoma Supreme Court's decision. Perhaps indicative of some impatience with the need yet again to repeat the exercise, the Court opened the most recent opinion with the following observation: "State courts rather than federal courts are most frequently called upon to apply the [FAA]…, including the Act's national policy favoring arbitration. It is a matter of great importance, therefore, that state supreme courts adhere to a correct interpretation of the legislation."

Noting that "[i]t is well settled that 'the substantive law the [FAA] created [is] applicable in state and federal courts,'"[19] the Court struck down an Oklahoma Supreme Court decision that refused to enforce an arbitration clause on the ground the confidentiality and non-competition agreements in which it was contained were rendered invalid by an Oklahoma statute.[20]

REGULATORY ACTIVITY

The Financial Industry Regulatory Authority ("FINRA") continues its disciplinary action asserting that the class action waiver Charles Schwab & Co. inserted post-*Concepcion* in its customer arbitration clause violates FINRA rules.[21] So far as we know, no other broker-dealer has followed Schwab's lead and placed a class action waiver in its customer agreement. FINRA's Customer Code of Arbitration Rule 12204(a) provides that "[c]lass action claims may not be arbitrated under the Code." FINRA's Industry Code of Arbitration contains the same prohibition in Rule 13204(a)(1), and also states, in Rule 13204(b)(1), that "[c]ollective action claims under the Fair Labor Standards Act, the Age Discrimination in Employment Act, or the Equal Pay Act of 1963 may not be arbitrated under the Code."

Thus, so long as the FINRA disciplinary proceeding against Schwab is pending (including any appeal of FINRA's decision in that matter), further Supreme Court jurisprudence on class action waivers and class arbitration may be of little practical relevance to broker-dealers in their dispute resolution dealings with customers—firms apparently will not seek to use class action waivers and class arbitration will continue to be barred by the FINRA rules. As to disputes with employees, however, a Southern District of New

York judge has enforced class and collective action waivers in UBS's compensation plan and other agreements.[22] That court held that "Plaintiffs' selective reading of the [FINRA arbitration] Code as absolutely prohibiting class and collective waiver is incorrect."[23]

The CFPB received a number of responses to its request last spring for suggestions on how to go about its study of predispute arbitration agreements in connection with the offering and providing of consumer financial products or services.[24] It has retained Professor Christopher Drahozal of the University of Kansas School of Law as a research consultant. The SEC study has had less visibility, which is not surprising given the number of other SEC studies and rulemakings mandated by the Dodd-Frank Act.

CONCLUSION

The Supreme Court's defense of the Federal Arbitration Act from the predations of state court judges has been unstinting. 2013 will see how far the Court will go to preserve arbitration as a vehicle for individual dispute resolution when the parties' agreement forbids class treatment or when the parties have not specifically agreed to class or other collective treatment. At the same time, at least in the financial services area, regulatory developments potentially may overshadow the Supreme Court's efforts. Financial industry firms with an interest in seeing arbitration remain viable as a means of individualized dispute resolution should make their voices heard in the regulatory reviews of arbitration and in any subsequent rulemaking process.

NOTES

[1] *American Express Travel Related Services Co. v. Italian Colors Restaurant*, No. 12-133 (*certiorari* granted Nov. 9, 2012); *see In re American Express Merchants' Litigation*, 667 F.3d 204 (2d Cir. 2012) ("*Amex III*"); 681 F.3d 139 (2d Cir. 2012) (*in banc* review denied).

[2] 473 U.S. 614, 632, 637 n.19 (1985). In that decision, the Court stated that, should provisions in a contract operate "as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy." *See also Green Tree Financial*

Corp.-Alabama v. Randolph, 531 U.S. 79, 82, 90 (2000) (dicta) ("the existence of large arbitration costs could preclude a litigant…from effectively vindicating her federal statutory rights in the arbitral forum"); *Gilmer v. Interstate/Johnson Lane Corp*., 500 U.S. 20, 28 (1991).

[3] 131 S. Ct. 1740 (2011).

[4] *See In re American Express Merchants' Litigation*, 634 F.3d 187 (2011) ("Amex II") (court held that *Stotlt-Nielsen* did not require departure from its original analysis); *In re American Express Merchants' Litigation*, 554 F.3d 300 (2009) ("Amex I"), vacated and remanded, 130 S. Ct.1758 (2010). This litigation was commenced in 2003.

[5] *Id*. at 217. *See, e.g., LaVoice v. UBS Financial Services, Inc*., 2012 WL 124590 (S.D.N.Y. Jan. 13, 2012), holding that a plaintiff asserting, *inter alia*, Fair Labor Standards Act claims provided insufficient evidence that individual arbitration would result in preclusion of his statutory rights, and finding "no legal basis for giving weight to" plaintiff's "and his counsel's professed disinclination to pursue LaVoice's claims individually…[because] the Court cannot help but find LaVoice and counsel's statements to be self-serving and irrelevant."

[6] 667 F.3d at 217. It is significant that Justice Sotomayor, who sat on the Second Circuit panel in *Amex I*, is recused from the case.

[7] *See In re Cotton Yarn Antitrust Litigation*, 505 F.3d 274, 285 (4th Cir. 2007); *Livingston v. Associates Finance, Inc*., 339 F.3d 553, 557 (7th Cir. 2003); *Adkins v. Labor Ready, Inc*., 303 F.3d 496, 503 (4th Cir. 2002); *Blair v. Scott Specialty Gases*, 283 F.3d 595, 604-10 (3d Cir. 2002); *Bradford v. Rockwell Semiconductor Systems, Inc*., 238 F.3d 549, 556-57 (4th Cir. 2001); *Williams v. Cigna Financial Advisors, Inc*., 197 F.3d 752, 763-64 (5th Cir. 1999); *Shankle v. B-G Maintenance Management of Colorado, Inc*., 163 F.3d 1230, 1234-35 (10th Cir. 1999).

[8] 130 S. Ct. 1758 (2010).

[9] The Supreme Court reversed the Second Circuit, which had reversed the district court's determination that the arbitration panel's decision must be vacated because it was made in "manifest disregard of the law."

[10] 130 S. Ct. at 1776. *See also AT&T Mobility LLC v. Concepcion*, 131 S. Ct. at 1748: "[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA."

[11] 675 F.3d 215 (3d Cir. 2012).

[12] 675 F.3d at 223. *But see Amex III*, 667 F.3d at 219: "*Stolt-Nielsen* plainly precludes any court from compelling the parties to submit to class-wide arbitration where the arbitration clause is silent as to class-wide arbitration."

[13] *See* 675 F.3d at 124 ("it is not for the district court to decide whether the arbitrator 'got it right'"); 9 U.S.C. § 10(a)(4).

[14] *Jock v. Sterling Jewelers Inc*., 646 F.3d 114 (2d Cir. 2011). *See also Fantastic*

Sams Franchise Corp. v. FSRP Assn. Ltd., 683 F.3d 18 (1st Cir. 2012) (leaving to the arbitrators the issue of whether an association of franchisees may proceed with arbitration against the franchisor on behalf of franchisees or whether association members must proceed individually).

[15] *Reed v. Florida Metropolitan Univ., Inc.*, 681 F.3d 630 (5th Cir. 2012) ("read[ing] Stolt-Nielsen as requiring courts to ensure that an arbitrator has a legal basis for his class arbitration determination;" holding that the parties' agreement to class arbitration cannot be inferred from an "any disputes" arbitration clause).

[16] *Marmet Health Care Center v. Brown*, 132 S. Ct. 1201, 565 U.S. ___ (Feb. 21, 2012) (*per curiam*) (vacating decision of West Virginia Supreme Court holding unenforceable all predispute arbitration agreements that apply to claims against nursing homes alleging personal injury or wrongful death).

[17] *KPMG LLP v. Cocchi*, 132 S. Ct. 23, 565 U.S. ____ (Nov. 7, 2011) (*per curiam*) (vacating decision of Florida Fourth District Court of Appeal; holding that a "court may not issue a blanket refusal to compel arbitration merely on the grounds that some of the claims could be resolved by the court without arbitration").

[18] *Nitro-Lift Technologies, L.L.C. v. Howard*, 133 S. Ct. 500, 568 U.S. ___ (Nov. 26, 2012) (*per curiam*).

[19] 133 S. Ct. at 503, quoting *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984).

[20] There is no dissent from any of the three *per curiam* decisions. Has Justice Thomas relented from his long-held position that the FAA "does not apply to proceedings in state courts"? *Green Tree Financial Corp. v. Bazzle*, 539 U.S. 444, 460 (2003) (Thomas, J., dissenting); *see also Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 689 (1996) (Thomas, J., dissenting); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 285-97 (1995) (Thomas, J., dissenting). Indeed, the holding in *Nitro-Lift* seems directly contrary to the position Justice Thomas espoused in his dissent in *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 449 (2006): "in state-court proceedings, the FAA cannot be the basis for displacing a state law that prohibits enforcement of an arbitration clause contained in a contract that is unenforceable under state law."

[21] The portion of Schwab's arbitration clause challenged by FINRA provides as follows:

> Waiver of Class Action or Representative Action.
>
> Neither you nor Schwab shall be entitled to arbitrate any claims as a class action or representative action, and the arbitrator(s) shall have no authority to consolidate more than one parties' claims or to proceed on a representative or class action basis. You and Schwab agree that any actions between us and/or Related Third Parties shall be brought solely in our individual capacities. You and Schwab hereby waive any right to bring a class action, or any type of representative action against each

other or any Related Third Parties in court. You and Schwab waive any right to participate as a class member, or in any other capacity, in any class action or representative action brought by any other person, entity or agency against Schwab or you.

[22] *Cohen v. UBS Financial Services, Inc.*, 2012 WL 6041634 (S.D.N.Y. Dec. 4, 2012).

[23] *Id.* at *3; see also the same judge's decision in *LaVoice v. UBS Financial Services, Inc.*, 2012 WL 124590 (S.D.N.Y. Jan. 13, 2012) ("this Court must read *AT&T Mobility [LLC v. Concepcion]* as standing against any argument that an absolute [statutory] right to collective action is consistent with the FAA's 'overarching purpose' of 'ensur[ing] the enforcement of arbitration agreements according to their terms so as to facilitate streamlined proceedings'" (quoting *Concepcion*, 131 S. Ct. at 1748); enforcing class and collective action waivers in UBS's compensation plan, forgivable loan agreements and other agreements).

[24] That notice is available at https://www.federalregister.gov/articles/2012/04/27/2012-10189/request-for-information-regarding-scope-methods-and-data-sources-for-conducting-study-of-pre-dispute.