

SIGNIFICANT 2009-10 “ARBITRABILITY” CASES IN FEDERAL APPELLATE COURTS

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THE CUTTING EDGE OF ARBITRATION:
WHAT YOU NEED TO KNOW

Courts typically deal with arbitration-related disputes in two circumstances. First, when a party to a contract with an arbitration clause resists arbitrating a dispute, the contracting parties often litigate the enforceability and scope of the arbitration clause (i.e. the “arbitrability” of the dispute) before any arbitration proceeding begins. Second, after an arbitration panel renders its decision and issues an award, parties frequently turn to the courts in an effort to confirm, modify, or vacate the arbitral award. Because recent ABA panels have focused extensively on the second category of cases and the impact of the United States Supreme Court decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 128 S. Ct. 644 (2007) on vacatur actions, the focus of this paper is on recent developments in the first category of cases regarding the “arbitrability” of disputes. This paper summarizes the “arbitrability” cases decided by the United States Supreme Court in the 2009-10 term, as well as the significant federal courts of appeals cases decided between January 2009 and June 2010, when this paper went to press.

I. UNITED STATES SUPREME COURT CASES (2009-10 TERM)

Rent-A-Center, West, Inc. v. Jackson, -- S. Ct. -- , 2010 WL 2471058 (U.S. June 21, 2010).

Holding: A delegation clause in an arbitration agreement giving the arbitrator the authority to resolve enforceability challenges is presumptively valid.

Background and Analysis: The Supreme Court’s decision settles an important question in which there was a conflict in the federal circuit courts of appeal, a conflict created by the Ninth Circuit’s conclusion that parties cannot delegate authority to the arbitrator to decide issues of enforceability.

When he was hired by RAC, Antonio Jackson signed an agreement to arbitrate claims arising from his employment. The agreement also clearly and unmistakably required that any challenges to its enforceability likewise must be submitted to an arbitrator to decide. Despite the terms of his arbitration agreement, Jackson filed a complaint in the United States District Court for the District of Nevada alleging employment discrimination and retaliation. When RAC moved to dismiss Jackson’s complaint and compel arbitration, Jackson alleged that the agreement was unenforceable because certain provisions in his view were unconscionable. RAC, relying on the language of the agreement, argued that the unconscionability issue was for the arbitrator to decide. Jackson disagreed, arguing that only a court could decide the issue, even though his agreement required that it be arbitrated. The district court agreed with RAC and held that Jackson’s challenges to the enforceability of the Agreement must be decided by the arbitrator. The district court held alternatively that the Agreement was not unconscionable, and was therefore enforceable. Jackson appealed to the Ninth Circuit.

In a 2-1 decision, the Ninth Circuit affirmed in part, reversed in part, and remanded to the district court. The Ninth Circuit acknowledged that it was undisputed that the agreement clearly and unmistakably assigned the question of contract enforceability to the arbitrator in the first instance. The majority opinion at the Ninth Circuit held that notwithstanding the clear language, the mere allegation that an arbitration agreement is unconscionable required the district court—and not the arbitrator—to decide the issue. The dissent stated that the majority’s opinion “will send this case (not to mention all those run-of-the-mill ones) to a mini-trial in the district court to

determine an agreement's validity based on just the bare allegation of unconscionability, even when the contract language clearly and unmistakably chooses a different forum for that question." The Ninth Circuit, however, affirmed the district court's finding that the agreement's cost provision was not unconscionable, and remanded to the district court to decide two other unconscionability claims.

The Supreme Court reversed and held that Jackson's challenge to an arbitration agreement should be decided by an arbitrator chosen by the parties, and not a judge, because the agreement expressly delegated that authority to an arbitrator. The Supreme Court rejected arguments by Jackson and the Ninth Circuit's holding that the unconscionability issue must be one for the courts alone. The Court held that, if the delegation clause itself were undermined by other provisions of the arbitration agreement, then perhaps the clause could be attacked on that ground. Thus, for example, if provisions of the arbitration agreement other than that which delegated unconscionability to the arbitrator rendered it unreasonably difficult for the arbitrator to rule on the unconscionability question, then a court could intervene and refuse enforcement of the delegation clause.

However, that was not the case in *Rent-A-Center*, where Jackson challenged the arbitration agreement as a whole, contending that the agreement was both procedurally and substantively unconscionable. The Court noted that none of Jackson's substantive unconscionability challenges were specific to the delegation provision and that there were no other provisions of the arbitration agreement that would have rendered the delegation provision unconscionable.

***Stolt-Nielsen S.A. v. Animalfeeds Int'l Corp.*, 130 S. Ct. 1758 (Apr. 27, 2010).**

Holding: A class arbitration may be ordered only if there is a contractual basis for concluding that the parties agreed to submit to class arbitration.

Background and Analysis: The Supreme Court's decision reverses the opinion of the Second Circuit Court of Appeals, and addressed the issue whether parties can be forced to arbitrate class claims when the arbitration provision is silent—that is, where the provision neither authorizes nor prohibits class arbitration. The case arose in connection with a dispute between a shipping company and a customer regarding whether an agreement that was completely silent on the question of class arbitrations could be construed to permit them. The Supreme Court held that silence was not enough. It held instead that the agreement must affirmatively permit class actions in order for an arbitrator to preside over the case as a class action, as opposed to an individual dispute between the two parties to the agreement.

The case relies on two fundamental principles of the Federal Arbitration Act: (1) arbitration agreements are to be enforced as they are written; and (2) parties cannot be compelled to arbitrate disputes that they have not agreed to submit to arbitration. Both principles derive from the language of the FAA and the Supreme Court's long line of cases interpreting the FAA.

In focusing on the terms of the agreement itself, the Supreme Court expressly rejected reliance on purported public policies to undermine fidelity to the words of the arbitration

agreement. Accordingly, because the FAA preempts contrary state law, it is likely that parties will argue, based on this case, that the FAA preempts any state rules that would permit class arbitrations notwithstanding contractual language forbidding them or an agreement's silence on the issue.

Although the Stolt-Nielsen decision deals with silent arbitration agreements, those that do not address class actions, the opinion is likely to have significant impact on the interpretation of agreements that do expressly prohibit class actions. In cases involving arbitration agreements with express class action waivers (that is, arbitration agreements that expressly forbid class actions), it would appear that the decision in Stolt-Nielsen mandates that the agreements be enforced as written.

This issue likely will be addressed in the near future as motions are filed in pending class actions. Likewise, the Supreme Court recently granted certiorari in *AT&T Mobility v. Concepcion* (discussed on pages 9-10 below), in which it will be addressing the enforceability of an explicit class waiver contained in a consumer contract of adhesion.

Granite Rock Co. v. Int'l Broth. of Teamsters, -- S. Ct. --, 2010 WL 2518518 (June 24, 2010).

Holdings:

- The question of whether and when parties formed an agreement containing an arbitration clause is generally an “issue for judicial determination,” not an arbitrator (7-2).
- It was premature to recognize tortious interference by a non-signatory third party to a labor contract as a federal common law cause of action under Section 301(a) of the Labor-Management Relations Act (LMRA), assuming Section 301(a) authorizes such a cause of action. Other remedies may be available under federal, state and administrative law to remedy the interference of a third-party with a labor contract. The Court remanded for further litigation the federal breach of contract claims under an agency or alter-ego theory. (9-0).

Background and Analysis: The underlying dispute involved a June 2004 strike initiated by Teamsters Local 287 to force Granite Rock to accept its demands for a new labor contract. On July 2, 2004, while the strike was ongoing, the parties agreed on the terms of a new collective bargaining agreement. Local 287 submitted the new agreement to its membership for ratification which it is alleged occurred on that day.

The International Brotherhood of Teamsters (IBT) opposed the Local's decision to return to work with a back-to-work agreement shielding both the Local and the IBT from liability for past strike-related damages. In an effort to secure such an agreement, IBT instructed the Local and its members not to honor their agreement to return to work on July 5, and continue the strike to pressure the Company into accepting the immunity agreement. When Granite Rock refused the IBT and Local responded by announcing a company-wide strike impacting hundreds of employees including members of IBT Locals besides Local 287. Granite Rock then sought an injunction to end the strike in federal court under Section 301(a) of the LMRA. Initially the

District Court dismissed the lawsuit based on testimony that the new agreement had not been ratified. When employees later gave statements that ratification had occurred, Granite Rock made a motion for new trial. While this was pending a second ratification vote occurred on August 22 with the strike finally being called off on September 13, the day the District Court was scheduled to hear Granite Rock's motion. This mooted the need for injunctive relief, but the District Court ordered a new trial on whether the agreement was ratified on July 2 and damages. Local 287 claimed that the no-strike clause was not effective at least prior to August 22 and that the determination of when the contract was formed should be submitted to arbitration per the agreement's arbitration clause. With the ordering of a new trial and subsequent discovery Granite Rock learned of the deep involvement of the IBT and amended the complaint to include them.

During the trial phase in the U.S. District Court for the Northern District of California, a number of Granite Rock employees came forward to testify that the union had in fact submitted the agreement to its membership for ratification on July 2. Accepting a unanimous jury verdict, the district court found the agreement to be in effect as of July 2.

Prior to the jury trial the District Court dismissed Granite Rock's claim of tortious interference against the IBT on the basis that Section 301 only recognizes a cause of action for breach of a labor agreement, and the IBT was not a signatory to the agreements in question. The Ninth Circuit affirmed the district court on the dismissal of the tortious interference claim. The Ninth Circuit reversed the District Court, however, on the issue of whether the effective date of the collective bargaining agreement was subject to arbitration. The appellate court ruled that this issue was subject to arbitration and should not have been decided by the District Court. The Ninth Circuit explained that the language of the arbitration clause was not in dispute and accordingly the effective date should have been arbitrated. It cited the "national policy favoring arbitration" where ambiguities exist as to the scope of an agreement to arbitrate.

In a 7 to 2 decision authored by Justice Thomas, to which Justice Sotomayor dissented joined by Justice Stevens, the Supreme Court agreed with Granite Rock and overruled the Ninth Circuit, holding that, in the absence of clear and convincing evidence otherwise, contract formation and the date on which it occurs is properly decided by a court, not an arbitrator. The decision reinstated the unanimous jury verdict that the collective bargaining agreement containing a no-strike clause was ratified on July 2, and was in place when Local 287 resumed its strike. The dissent opined that, under the unique circumstances of the case, in which the parties later executed the same labor contract with an effective date prior to the strike, no contract formation dispute existed.

On the second issue, the Court unanimously rejected as premature a federal common law cause of action for tortious interference against the IBT. The Court remanded the case to allow Granite Rock to proceed against the IBT on the theory that the local union was acting as the IBT's agent (or alter ego) when it disavowed the collective bargaining agreement, finding nothing in the record to support the IBT's contention that these arguments had been waived. The Court also stated that a state law claim for tortious interference and administrative remedies through the National Labor Relations Board may remain viable remedies against the IBT for its alleged interference. The case was remanded for further proceedings consistent with the Supreme Court's opinion.

II. SIGNIFICANT UNITED STATES COURTS OF APPEALS CASES (JANUARY 2009 – JUNE 2010)

A. Cases Relating to the Enforceability of Arbitration Clauses

1. Who decides questions of arbitrability?

Fallo v. High Tech Institute, 559 F.3d 874 (8th Cir. 2009).

Holding: Contracting parties’ incorporation of AAA Rules constitutes clear and unmistakable evidence that they intend to allow an arbitrator to determine questions of arbitrability, removing these questions from the purview of a court. An arbitration provision’s incorporation of AAA rules even supersedes a choice-of-law provision, where the law chosen (Missouri) requires a court to determine the question of arbitrability as a matter of law.

Background and Analysis: Students brought tort claims against a vocational school. Invoking the arbitration agreement in the enrollment agreements, the school moved to compel arbitration. That arbitration agreement incorporated the AAA Rules, one of which gives the arbitrator “the power to rule on his or her own jurisdiction.” The district court denied the motion to compel, finding that it had the authority to determine questions of arbitrability and that the tort claims fell outside the scope of the arbitration clause. The Eighth Circuit reversed, finding that the incorporation of the AAA rules constituted “clear and unmistakable” evidence that the parties intended that questions of arbitrability would be resolved by the arbitrator. This is true even where the enrollment agreement contained a choice-of-law provision requiring application of Missouri law, which requires a court to determine questions of arbitrability as a matter of law.

Note: Cases discussing whether courts or arbitrators should adjudicate particular defenses to arbitration are set out in Section II.A.3 below.

2. Arbitration with Non-Signatories

a. Incorporation by Reference

Century Indem. Co. v. Certain Underwriters at Lloyd’s, London, 584 F.3d 513 (3d Cir. 2009).

Holdings:

- A party does not need to show that an arbitration agreement was “express” and “unequivocal” for the agreement to be enforceable, rather it must show that an agreement was formed under the standards applicable to contracts generally.
- A second-level reinsurer (Lloyd’s) could compel arbitration in a dispute with the first-level reinsurer (Century), even though the retrocessional agreements between them did not contain an arbitration clause, because those agreements incorporated by reference underlying reinsurance treaties that did contain an arbitration clause.

Background and Analysis. Argonaut, the original insurer for various asbestos companies, entered into various reinsurance treaties with a predecessor of Century, all of which contained arbitration clauses. Century attempted to spread its exposure to risk through further reinsurance and did so by entering retrocessional agreements (i.e., reinsurance of reinsurance) with Lloyd's. The Lloyd's/Century retrocessional agreements did not contain arbitration clauses, but incorporated the underlying reinsurance treaties by reference. When Century sued Lloyd's over Lloyd's failure to pay for certain litigation expenses incurred by Argonaut, Lloyd's moved to compel arbitration. The district court granted the motion to compel. After an arbitration panel ruled in Lloyd's favor, Century sought to vacate the award on the ground that it had not agreed to arbitrate its dispute with Lloyd's.

The Third Circuit analyzed two threshold questions, finding that (1) the presumption of arbitrability applies to the question of whether the dispute falls within the scope of an arbitration agreement, but "probably" does not apply to the predicate question of whether there is a valid agreement to arbitrate between the parties in the first place; and (2) a party need not show that an arbitration agreement was "express" and "unequivocal" to be enforceable; rather it must show that an agreement was formed under the standards applicable to contracts generally.

Applying Pennsylvania contract law, the Third Circuit then turned to the question of whether Lloyd's, despite being a non-signatory to the reinsurance treaties containing the arbitration clause, could nevertheless compel arbitration on the ground that the arbitration provisions were incorporated by reference in the retrocessional agreement. Century argued that such incorporation should not be found because (1) the phrasing of the arbitration clause in the reinsurance treaties specified that it applied only to disputes between Century and Argonaut; and (2) the general incorporation provision in the retrocessional agreement was intended only to clarify the parties' obligations under the reinsurance agreements, not to agree to a procedure for resolution of disputes. The Court rejected these arguments based primarily on the breadth of the general incorporation provision in the retrocessional agreement. It found that the arbitration provisions in the reinsurance contracts were incorporated by reference in the retrocessional agreement and that the arbitration of the parties' dispute was proper. The Court found that the parties' dispute also fell within the scope of the arbitration clause, and that Century's asserted grounds for vacatur – that the arbitrators improperly excluded key evidence – failed.

b. Equitable/Alternative Estoppel

PRM Energy Sys., Inc. v. Primenergy, LLC, 592 F.3d 830 (8th Cir. 2010).

Holding: Under the doctrine of "alternative estoppel," a non-signatory can compel a signatory to arbitrate when the signatory's claims are so intertwined with the agreement containing the arbitration clause that it would be unfair to allow the signatory to rely on the agreement in formulating its claims but to disavow availability of the arbitration clause of that same agreement.

Background and Analysis: PRM licensed certain patents to Primenergy, L.L.C. through a network of agreements containing an arbitration clause. After disputes arose between the two parties, PRM sued Kobe Steel, a potential sublicense, for tortious interference with, and

inducement to breach the PRM/Primenergy agreements and with conspiring with Primenergy to convert PRM's intellectual property for their own use. Kobe Steel successfully moved to arbitrate the dispute in the district court and the Eighth Circuit affirmed.

The Eighth Circuit found the “the nature of the alleged misconduct and its connection to the contract demonstrates the requisite relationships between persons, wrongs, and issues necessary to compel arbitration.” The court called this form of estoppel “alternative estoppel,” relying on a concerted misconduct test from the Eleventh Circuit. The “alternative estoppel” theory adopted by the Eighth Circuit has been labeled “equitable estoppel in other circuits. *See, e.g., Grigson v. Creative Artists Agency*, 210 F.3d 524, 528 (5th Cir. 2000) (holding that equitable estoppel applies “when a signatory to a contract containing an arbitration clause raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract.”).

Mundi v. Union Sec. Life Ins. Co., 555 F.3d 1042 (9th Cir. 2009).

Holding: The Ninth Circuit refused to apply equitable estoppel to compel a signatory to arbitrate with a non-signatory defendant, because the signatory's claim was not intertwined with the contract providing for arbitration and did not arise from the contract.

Background and Analysis: A decedent and his widow obtained a loan, which was memorialized in a document containing an arbitration agreement. They also purchased a life insurance policy from USLIC to cover the amount of the loan. The policy did not contain an arbitration agreement. After the decedent's death, his widow filed a complaint against USLIC for bad faith denial of her insurance claim, and USLIC moved to compel arbitration. USLIC sought to enforce the loan's arbitration agreement, even though it was not a party to that agreement, under equitable estoppel theory.

The Ninth Circuit held that USLIC could not compel arbitration. The Court first held that a dispute with a third party such as USLIC fell outside the scope of the arbitration agreement, which addressed only disputes between the bank and the borrower. Next, the Court held that equitable estoppel did not apply. The Court explained that there are two types of equitable estoppel. In the first, a non-signatory may be held to an agreement containing the arbitration clause despite having never signed the agreement. In the second, a signatory may be required to arbitrate a claim brought by a non-signatory because of the close relationship between the entities involved, as well as the relationship of the alleged wrongs to the non-signatory's obligations and duties in the contract and the fact that the claims were intertwined with the underlying contractual obligations.

The Court declined to apply equitable estoppel because the claim involved was not intertwined with the contract providing for arbitration and did not arise from or relate directly to the agreement.

Donaldson Co. v. Burroughs Diesel, Inc., 581 F.3d 726 (8th Cir. 2009).

Holding: Equitable estoppel did not bind a signatory to arbitrate with a non-signatory where the signatory did not rely on the agreement to assert its claims against the non-signatory, and there was no coordinated behavior between a signatory and non-signatory.

Background and Analysis: Western Star manufactured trucks that it sold to Burroughs, and the parties signed an agreement containing an arbitration provision. Donaldson supplied parts for the trucks and was not a party to the agreement. When a problem arose with the trucks, Burroughs brought claims against Donaldson and Western Star in state court. Western Star filed suit against Burroughs in district court to compel arbitration between Western Star and Burroughs. Donaldson then moved to compel Burroughs to arbitrate with it, relying on equitable estoppel theories.

The Eighth Circuit applied Mississippi law and held that even if Mississippi recognized equitable estoppel, it did not apply to the instant case. First, the Court determined that Burroughs did not rely on its agreement with Western Star to assert its claims against Donaldson. Second, the Court determined that Burroughs did not allege substantially interdependent and concerted misconduct because it did not suggest that Donaldson and Western Star “knowingly acted in concert” or “worked hand-in-hand.”

c. Third Party Beneficiary

Todd v. Steamship Mut. Underwriting Ass’n, 601 F.3d 329 (5th Cir. 2010).

Holding: A direct action plaintiff may be required to arbitrate as a third party beneficiary to an arbitration contract, even though it is a non-signatory to the arbitration agreement.

Background and Analysis: Louisiana’s direct action statute allows injured individuals to proceed directly against tortfeasors’ insurers in certain circumstances. In two prior cases, *Zimmerman* and *Big Foot*, the Fifth Circuit had held that direct action plaintiffs’ suits could not be stayed pending arbitration because the direct action plaintiffs were not parties to arbitration agreements. See *Zimmerman v. Int’l Co. & Consulting, Inc.*, 107 F.3d 344 (5th Cir. 1997); *In re Talbott Big Foot, Inc.*, 887 F.2d 611(5th Cir. 1989). Relying on *Zimmerman* and *Big Foot*, the district court in *Todd* refused to compel a direct action plaintiff to arbitrate.

The Fifth Circuit reversed, in light of the Supreme Court’s recent opinion in *Arthur Andersen LLP v. Carlisle*, ___ U.S. ___, 129 S. Ct. 1896 (2009). The Fifth Circuit held that *Carlisle* effectively overruled *Zimmerman* and *Big Foot* by holding that non-signatories to arbitration agreements (such as direct action plaintiffs) sometimes can be compelled to arbitrate. The Court remanded so that the district court could determine whether the direct action plaintiff could be required to arbitrate as a third party beneficiary.

3. Defenses to Enforcement

a. Unconscionability

Laster v. AT&T Mobility LLC, 584 F.3d 849 (9th Cir. 2009), cert. granted sub nom, *AT&T Mobility LLC v. Conception*, 78 U.S.L.W. 3454, 78 U.S.L.W. 3677, 78 U.S.L.W. 3687 (U.S. May 24, 2010) (No. 09-893).

Holdings:

- An arbitration agreement containing a class action waiver was unconscionable and unenforceable under California law, and was not saved by a provision authorizing the payment of a \$7500 premium to a customer if the customer obtained an arbitration award greater than the company’s last written settlement offer.
- The FAA did not expressly or impliedly preempt California law governing unconscionability. (The Supreme Court has granted AT&T’s petition for writ of certiorari on this question).

Background and Analysis. Customers brought a putative class action against AT&T, claiming that the company’s offer of a free phone for signing up for telephone service was fraudulent because the company imposed a sales tax based on the retail value of the new phones. AT&T moved to compel arbitration based on an arbitration clause in the service agreement, which (1) prohibited class arbitration; and (2) required AT&T to pay a \$7500 premium to any customer that obtained an arbitration award greater than AT&T’s last written settlement offer before the arbitration. The district court denied the motion to compel and the Ninth Circuit affirmed.

Relying on a three-part test set out by a previous panel, the Ninth Circuit found that the class action waiver provision in the arbitration clause was unconscionable under California law because (1) the agreement at issue was a contract of adhesion; (2) the dispute involved predictably small amounts of damages; and (3) it was alleged that the party with superior bargaining power (AT&T) carried out a scheme deliberately to cheat large numbers of consumers out of individually small amounts of money. The premium provision included in the arbitration clause did not change the analysis of the second factor because AT&T easily could take the premium off the table by offering the customer the face value of its claim (usually \$30.22), eliminating any incentive to bring a claim.

The Ninth Circuit also found that the FAA did not expressly or impliedly preempt California law, reasoning that the unconscionability “rule” it applied was not an arbitration-specific rule, but rather applied generally to all contracts under California law. Accordingly, the rule fell within the scope of 9 U.S.C. § 2 (arbitration clauses “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract”).

Petition for Writ of Certiorari: AT&T’s petition raised the following question: “Whether the Federal Arbitration Act preempts States from conditioning the enforcement of an arbitration agreement on the availability of particular procedures—here, class-wide arbitration—when those procedures are not necessary to ensure that the parties to the arbitration agreements are able to vindicate their claims.” The petition points out that hundreds of millions of arbitration agreements require that arbitration proceed on an individual basis and that unlike California, most states have upheld the enforceability of such agreements, as long as they do not impose substantial costs on the non-drafting party nor limit that party’s remedies. AT&T challenges the Ninth Circuit’s finding that these unconscionability rules apply to all contracts generally under California law, and argues that these arbitration-specific requirements (requiring class arbitration when the three-part test set out above is satisfied) are preempted by the FAA.

Puleo v. Chase Bank USA, N.A., 605 F.3d 172 (3d Cir. 2010) (6-4 en banc decision).

Holdings:

- A challenge to the enforceability of an explicit class action waiver provision within an arbitration agreement is a challenge to the validity of the parties’ agreement to arbitrate, and is thus a question for the court to decide.
- Under the terms of a severability clause in the arbitration agreement, the district court had to address the contention that the class action waiver was unconscionable before considering whether the waiver could be severed.
- The parties did not contract around the general rule that questions regarding the validity of an arbitration agreement were for the court to resolve.

Background and Analysis: The Puleos brought a putative class action challenging retroactive interest-rate increases on the account balances of their credit cards, despite the fact that their credit card agreement contained an arbitration clause with a class action waiver provision. After Chase moved to compel arbitration, the Puleos urged the district court to order the parties to arbitrate the class claims, contending that the question of whether the class waiver was unconscionable was for the arbitrator, not the court, to decide. The district court held that it first must decide the enforceability of the class action waiver, found the waiver enforceable, and compelled the Puleos to arbitrate their claims on an individual basis. The Third Circuit, sitting en banc, affirmed.

The Third Circuit held that when a party challenges the validity of the arbitration clause itself, the question is presumptively for the court to decide, not the arbitrator. The Third Circuit rejected the Puleos’ arguments that this general rule was inapplicable because of (1) their willingness to arbitrate, albeit not under the terms of the class waiver provision, (2) the presence of a severability clause in the arbitration agreement, or (3) the parties intended to reserve questions of arbitrability for the arbitrator. On the latter point, the Puleos did not demonstrate that the parties “clearly and unmistakably” agreed to submit questions regarding the validity of the arbitration agreement to the arbitrator. The dissent argued that because both parties agreed

that their dispute was arbitrable, the issue of arbitrability was not on the table and the enforceability of the class waiver provision was for the arbitrator to decide.

Omstead v. Dell, Inc., 594 F.3d 1081 (9th Cir. 2010).

Holdings:

- A class action waiver of arbitration was unconscionable under California law.
- Application of a choice-of-law provision designating Texas law would violate a fundamental policy of California and the provision would not be enforced.
- A class action waiver provision is not severable from the remainder of the contract.

Background and Analysis: Customers brought a putative class action against Dell alleging various state law claims arising out of their purchase of notebook computers. The purchase agreement contained an arbitration clause, a class action waiver provision, and a choice-of-law provision designating Texas law as controlling. The district court granted Dell's motion to compel arbitration. The Ninth Circuit reversed.

The Ninth Circuit held that the choice-of-law provision was unenforceable as violative of the fundamental public policy of California. The Court found that under California law, the class action waiver was unconscionable because the sales agreement was a contract of adhesion, the amount in controversy was small enough to prevent customers from bringing individual claims, and the plaintiff alleged a deliberate practice of depriving customers of money. Further, the class action provision was not severable because it was "central" to the arbitration provision.

Pendergast v. Sprint Nextel Corp., 592 F.3d 1119 (11th Cir. 2010).

In a putative class action brought by a wireless customer against a wireless service provider, the Eleventh Circuit certified the following questions to the Florida Supreme Court in order to determine whether the district court's order compelling arbitration should be reversed or affirmed: "(1) Must Florida courts evaluate both procedural and substantive unconscionability simultaneously in a balancing or sliding scale approach, or may courts consider either procedural or substantive unconscionability independently and conclude their analysis if either one is lacking?; (2) Is the class action waiver provision in Plaintiff's contract with Sprint procedurally unconscionable under Florida law?; (3) Is the class action waiver provision in Plaintiff's contract with Sprint substantively unconscionable under Florida law? (4) Is the class action waiver provision in Plaintiff's contract with Sprint void under Florida law for any other reason?" The case is currently pending in the Florida Supreme Court.

Pokorny v. Quixtar, Inc., 601 F.3d 987 (9th Cir. 2010).

Holding: An alternative dispute resolution clause requiring a party to engage in an "informal and formal conciliation" process prior to arbitration was both procedurally and substantively unconscionable under the facts of this case.

Background and Analysis. Quixtar markets a variety of products and services that it sells to consumers through a network of individual distributors that it refers to as “Independent Business Owners (“IBOs”). Certain senior IBOs also produce and market “business and support materials to junior IBOs. A group of junior IBOs brought suit against Quixtar and certain senior IBOs, alleging that they operate an illegal pyramid scheme in violation of the RICO statute. The defendants moved to dismiss the suit, or in the alternative, to compel plaintiffs to resolve their claims through a mandatory ADR process outlined in the IBO agreements. That process required a plaintiff to go through a three-step procedure: (1) an “Informal Conciliation” with Quixtar, likened to a mediation; (2) a “Formal Conciliation,” which involved a non-binding hearing before a board of senior IBOs, which then would issue a recommendation that could be accepted, reversed or modified by Quixtar; and (3) binding arbitration, limited by certain “Rules of Conduct.” The district court denied the motion to dismiss, holding that the ADR process was unconscionable. The Ninth Circuit affirmed.

Under California law, an arbitration agreement is unenforceable if it is both procedurally and substantively unconscionable. The Ninth Circuit found that the ADR procedures were procedurally unconscionable, because (1) Quixtar occupied a superior bargaining position, (2) the agreements were presented to the plaintiffs on a take-it-or-leave-it basis, with no opportunity for meaningful negotiation, and (3) Quixtar failed to attach a copy of the Rules of Conduct, which contained the full description of the non-binding conciliation and binding arbitration processes, and which was subject to unilateral amendment by Quixtar at any time. The Ninth Circuit found the conciliation procedures to be substantively unconscionable, because among other reasons, the lack of mutuality of the requirement, the shortened statute of limitations created by the Rules of Conduct, Quixtar’s unilateral and unchecked right to reverse or modify the IBO hearing panel’s recommendation (while getting a “free peek” at its opponents’ case), and the inability of an IBO to effectively challenge the Rules of Conduct through the conciliation process. Finally, the Ninth Circuit found the third-stage binding arbitration process to be substantively unconscionable as well, based on the lack of mutuality in the requirement that IBOs engage in binding arbitration, the reduced statute of limitations imposed by the Rules of Conduct, the unilateral confidentiality requirement imposed on IBOs, the inclusion of an arbitration selection process that unfairly favored Quixtar, and the inclusion of a fee-shifting provision that requires the losing party to bear the costs of the arbitration, including the prevailing party’s attorneys’ fees.

Harrington v. Atl. Sounding Co., Inc., 602 F.3d 113 (2d Cir. 2010).

Holding: The Second Circuit held that an arbitration agreement was not substantively unconscionable under New Jersey law, reversing the contrary holding of the district court.

Background and Analysis: The plaintiff was injured while working as a seaman for the defendants. Unable to work, the plaintiff asked the defendants for financial support to cover his injury and upcoming surgery. In response, the plaintiff and the defendants signed a Claim Arbitration Agreement, in which the defendants agreed to pay the plaintiff 60% of his wages, the plaintiff agreed that these payments would be an advance against any settlement, and the plaintiff agreed all claims would be arbitrated. The plaintiff later filed suit against the defendants in

district court, and the defendants moved to compel arbitration. The district court ruled that the agreement was both procedurally and substantively unconscionable, reasoning that the plaintiff was heavily medicated when he signed the agreement, and the agreement created a false impression that the defendants were not subject to any liability by stating that the defendants were not “currently responsible or liable.”

The Second Circuit reversed, reasoning that under New Jersey law, procedural unconscionability (which includes “various inadequacies like age, literacy, and lack of sophistication”) is not enough not make an arbitration agreement unenforceable. Rather, substantive unconscionability must also be present. To be substantively unconscionable, an agreement must include “an exchange of obligations so one-sided as to shock the court’s conscience.” The Second Circuit held that the Claim Arbitration Agreement “had no such effect.” To hold that an advance of funds in exchange for an agreement to arbitrate shocked the conscience “would contravene the ‘liberal federal policy favoring arbitration agreements.’” Therefore, the Court remanded so that the district court could consider the plaintiff’s other defenses to arbitration.

Ragone v. Atl. Video at the Manhattan Ctr., 595 F.3d 115 (2d Cir. 2010).

Holding: An agreement to arbitrate could be enforced where the parties seeking to compel arbitration agreed to waive provisions that otherwise might have been found to be unconscionable.

Background and Analysis: The plaintiff brought a Title VII employment discrimination action against AVI and ESPN. AVI moved to compel arbitration pursuant to an arbitration agreement with the plaintiff. The plaintiff resisted arbitration, arguing that several of the provisions in the arbitration agreement were unconscionable. In particular, the plaintiff complained that the arbitration agreement impermissibly shortened the statute of limitations to 90 days and required that attorney’s fees be awarded to the prevailing party. The defendants waived enforcement of these two provisions, and the district court accordingly ruled that the agreement was not unconscionable.

The Second Circuit affirmed, holding that the district court could enforce an agreement that modifies a provision that otherwise might have been unconscionable. The Court was careful to note, however, that had the provisions not been waived, they might have impermissibly diminished rights under Title VII.

In a separate issue, the Court held that under the doctrine of equitable estoppel, ESPN could invoke the arbitration clause and be a party to the arbitration, even though it was a non-signatory to the arbitration agreement. The Court determined there was no question that the subject matter of the dispute between the plaintiff and AVI was factually intertwined with the dispute between the plaintiff and ESPN, because it was, “in fact, the same dispute.” The Court also found it relevant that the plaintiff knew from the beginning of her employment with AVI that she would regularly work with and be supervised by ESPN personnel. The Court held that this relationship allowed ESPN to avail itself of the arbitration agreement.

Cicle v. Chase Bank USA, 583 F.3d 549 (8th Cir. 2009).

Holding: An arbitration clause in a credit card agreement, which included a class action waiver and various fee and cost-sharing provisions, was neither procedurally nor substantively unconscionable under Missouri law, reversing the contrary holding of the district court.

Background and Analysis: Under Missouri law, a party challenging the enforceability of an arbitration provision must show that it is both procedurally and substantively unconscionable. The Eighth Circuit found that the arbitration clause in the credit card agreement between Chase and the plaintiff was neither. With respect to the procedural unconscionability inquiry, the Court noted that (1) the arbitration clause was not in a smaller font size than the remainder of the document, (2) the arbitration agreement and class-action waiver were introduced by a boldfaced heading and a paragraph in all-uppercase font, (3) the class action waiver always had been a part of the credit card agreement, (4) the plaintiff had ample time to opt out of the amendments to the agreement imposing various cost- and fee-sharing provisions before they took effect, and (5) there was no evidence that Chase engaged in high-pressure sales tactics to coerce the plaintiff into entering into the agreement.

The Eighth Circuit likewise rejected the district court's finding that the agreement was substantively unconscionable, which requires a showing that the agreement is one which "no man in his senses and not under delusion would make, on one hand, and one that no honest and fair man would accept." The district court had concluded that class action waiver was unconscionable because there was no effective remedy for cardmembers that had suffered small actual damages. The Eighth Circuit rejected this argument, largely based on an exception in the arbitration clause that allowed a cardmember to file a claim individually in small claims court. The Court also did not find unconscionable a provision that contemplated a sharing or shifting of costs and fees, at the arbitrator's discretion, after the second day of any arbitration hearing (Chase agreed to pay the initial filing fee and arbitrator fees for the first two hearing days).

G.R. Homa v. American Express Co., 558 F.3d 225 (3d Cir. 2009).

Holdings:

- FAA did not preempt the consideration of the unconscionability of a class arbitration waiver provision.
- The class arbitration waiver provision in the credit card agreement was unconscionable.

Background and Analysis: A cardholder brought a putative class action against a credit card company and an issuing bank. The cardholder agreement had an arbitration clause, a class arbitration waiver provision, and a choice-of-law provision requiring application of Utah law (which expressly allows class arbitration waivers in consumer credit agreements). The district court granted AMEX's motion to compel arbitration, and the Third Circuit reversed.

The Third Circuit first determined that the unconscionability defense urged by the cardholder was a general contract defense that applies to waivers of all class-wide actions,

whether in arbitration or in court. Therefore, the FAA did not preempt the state law unconscionability analysis. *See* 9 U.S.C. § 2. Next, the Court determined that the Utah choice-of-law provision would violate New Jersey public policy, and therefore refused to enforce it. Finally, the Court found that the class arbitration provision was unconscionable under New Jersey law because the cardmember agreement was a contract of adhesion, presented on a take-it-or-leave-it basis in standardized print form, without the opportunity to negotiate, and because the low monetary value of the claims effectively precluded a plaintiff from bringing claims on an individual basis.

Chalk v. T-Mobile USA, Inc., 560 F.3d 1087 (9th Cir. 2009).

Holdings:

- Arbitration clause was not procedurally unconscionable under Oregon law.
- A class action waiver provision was substantively unconscionable under Oregon law.
- The waiver provision was not severable, and thus, the entire arbitration clause was unenforceable.

Background and Analysis: Customers brought a putative class action against T-Mobile arising out of their purchase of wireless cards. The purchase agreement contained an arbitration clause, a class action waiver provision, and a severability provision forbidding severance of the class action waiver provision. The district court granted T-Mobile's motion to compel arbitration. The Ninth Circuit reversed.

The Ninth Circuit held that the take-it-or-leave-it nature of the agreement was insufficient to render the arbitration provision procedurally unconscionable under Oregon law, particularly where the arbitration clause and class action waiver are featured in boldface and uppercase text. However, a finding of substantive unconscionability is enough to render a contract provision invalid under Oregon law. Because of the disparity in bargaining power, the one-sided nature of the class action waiver provision, and the inability of consumers to vindicate their rights on an individual basis, the Ninth Circuit found the waiver provision to be substantively unconscionable. Further, in light of the contractual provision prohibiting severance of the class action waiver, the Court found the entire arbitration agreement to be unenforceable.

b. Compliance with a Condition Precedent

Dealer Computer Servs., Inc. v. Old Colony Motors, 588 F.3d 884 (5th Cir. 2009).

Holding: Payment of arbitration-related fees is a procedural condition precedent to arbitration that the arbitrator should review, not the court.

Background and Analysis: Dealer Services filed an arbitration demand against Old Colony, and Old Colony filed counterclaims. Old Colony was unable to pay its proportional share of deposits for the arbitrator's fees and expenses, so Dealer Services filed suit under 9

U.S.C. § 4 to compel Old Colony to pay its share. The trial court granted the motion to compel and ordered Old Colony to pay the deposit.

The Fifth Circuit reversed, holding that payment of fees is a procedural condition precedent to arbitration and is within the purview of the arbitrators, not the courts. Under the AAA Rules, arbitrators have the discretion to order either party to pay the fees upon the failure of payment in full. If the party that fails to pay the fees prevails in the proceeding, the fees may be subtracted from its recovery. If the party that fails to pay the fees loses, the arbitrators may add the fees to the final award. The Fifth Circuit remanded the case to the district court with instructions to dismiss Dealer Services' motion to compel.

c. Waiver

Hill v. Ricoh Americas Corp., 603 F.3d 766 (10th Cir. 2010).

Holding: Defendant did not waive its right to arbitrate by waiting five months after the lawsuit was filed to move to compel arbitration.

Background and Analysis: The Tenth Circuit held that Defendant did not waive its right to arbitrate, even though it waited five months after suit was filed to move to compel arbitration. Very little activity had taken place in the case before Defendant's demand for arbitration. The trial was not set for another eleven months, discovery could continue for another five-and-a-half months, and the deadline for completing ADR was more than two months away.

Nicholas v. KBR, Inc., 565 F.3d 904 (5th Cir. 2009).

Holding: The filing of a lawsuit is generally a substantial invocation of the judicial process, sufficient to establish waiver of the right to arbitrate as long as the party resisting arbitration can show prejudice.

Background and Analysis: Without any mention of an arbitration agreement, Plaintiff filed a lawsuit, filed a motion to remand, amended her complaint, responded to discovery, and sat for her deposition. Ten months after filing suit, and after an unfavorable legal ruling, Plaintiff moved to compel arbitration. The district court ruled that Plaintiff waived the right to arbitrate.

The Fifth Circuit affirmed. The Court held that "the act of a plaintiff filing suit without asserting an arbitration clause constitutes substantial invocation of the judicial process, unless an exception applies." Concluding that Plaintiff had substantially invoked the judicial process, the Court went on to find that the defendant was prejudiced because it had conducted the bulk of activity necessary to defend against Plaintiff's claims.

Petroleum Pipe Americas Corp. v. Jindal Saw, Ltd., 575 F.3d 476 (5th Cir. 2009).

Holding: Defendant waived its right to arbitrate by waiting to seek arbitration until after the trial court indicated that it would rule against Defendant.

Background and Analysis: Before seeking to compel arbitration, Defendant removed the case to federal court, filed counterclaims, and participated in discovery and numerous discovery meetings. One year after the plaintiff filed suit, the trial court indicated in a status conference that it would rule against Defendant. It was only then that Defendant moved to compel arbitration. The Fifth Circuit held that Defendant waived its right to arbitrate by waiting to move to compel arbitration until after the district court's unfavorable pronouncements. This, the Court found, substantially invoked the judicial process and prejudiced the plaintiff.

Hooper v. Advance Am. Cash Advance Ctrs. of Missouri, Inc., 589 F.3d 917 (8th Cir. 2009).

Holding: A party filing an “extensive and exhaustive” motion to dismiss under Rule 12(b) waives the right to later seek arbitration of the dispute, even if the motion purports to “reserve the right” to enforce the arbitration clause if the motion is denied.

Background and Analysis: Advance America, a payday lender, moved to dismiss a putative class action brought against it under Rule 12(b)(1) and 12(b)(6) (for lack of subject matter jurisdiction and failure to state a claim, respectively), while “reserving its right” to enforce an arbitration clause in the loan agreements if its motion were denied. After portions of the plaintiff's lawsuit survived the “extensive” motion to dismiss, Advance America moved to stay litigation and compel arbitration. The district court denied the motion on the grounds of waiver and the Eighth Circuit affirmed.

Applying a three-part test, the Eighth Circuit found that a right to arbitration is waived when (1) a party was aware of its right to arbitration, (2) acted inconsistently with that right, and (3) did so to the detriment of the opposing party. The Court emphasized that Advance America “substantially invokes the litigation machinery” by filing an “extensive and exhaustive” motion to dismiss that required the district court to analyze many issues of first impression. However, the Court took pains to say that “[n]ot every motion to dismiss is inconsistent with the right to arbitration,” particularly motions that did not touch on the merits of a dispute or sought only the dismissal of frivolous claims.

Southeastern Stud & Components, Inc. v. Am. Eagle Design Build Studios, LLC, 588 F.3d 963 (8th Cir. 2009).

Holding: Defendant waived its right to arbitrate, even though its delay in moving to compel arbitration was based on its mistaken belief that it could not arbitrate under state law.

Background and Analysis: Defendant believed that it could not arbitrate under Arkansas law, which required mutuality of obligation within the arbitration agreement. Relying on this law, Defendant participated in discovery and filed a motion for judgment on the pleadings without raising the issue of arbitration. Over one year later, Defendant asserted for the first time that it had a right to arbitrate under a new unpublished federal district court case, which held that the Arkansas law requiring mutuality was preempted by the FAA.

The Eighth Circuit nevertheless held that Defendant waived its right to arbitrate. The Court reasoned that long before the new district court opinion allowing arbitration, United States Supreme Court precedent held that the FAA preempts state laws that withdraw the power to enforce arbitration agreements. The Eighth Circuit therefore concluded that, despite Arkansas case law to the contrary, “it should have been clear to [Defendant] that the arbitration agreement was at least arguably enforceable because Arkansas could not have imposed additional requirements that applied only to arbitration agreements.” Finding no valid excuse for Defendant’s delay, the Court held that Defendant acted inconsistently with its existing right to arbitrate by waiting thirteen months before asserting that right.

B. Cases Relating to the Scope of Arbitration Clauses.

***Chelsea Family Pharm., PLLC v. Medco Health Solutions, Inc.*, 567 F.3d 1191, 1196 (10th Cir. 2009).**

Holdings:

- Two factually distinct injuries pleaded in the same causes of action in a complaint constitute distinct “controversies or claims” whose arbitrability must be separately evaluated.
- In the face of a narrow arbitration clause, which authorized arbitration of “any controversy or claim arising out of or relating to payments to [plaintiff] by [defendant],” the court determined that one set of the plaintiff’s factual claims was subject to arbitration, while another was not.
- Because the two claims were distinct and unrelated, the district court did not need to stay the non-arbitrable claims pending resolution of the arbitrable claims.

Background and Analysis: Chelsea Family Pharmacy, a local pharmacy servicing retail customers, entered into an agreement with Medco Health, a third party prescription drug program administrator, to fill Chelsea’s prescriptions and facilitate insurance reimbursements. The agreement contained a clause requiring arbitration of disputes “arising out of or relating to payments to [Chelsea] by Medco.” Chelsea brought suit against Medco claiming two distinct factual injuries, despite commingling the factual allegations in setting forth its causes of action: (1) Medco unlawfully reimbursed Chelsea at lower than the prevailing rate; and (2) Medco operated its mail order program in a manner that unlawfully harmed Chelsea’s competitiveness.

The Tenth Circuit noted that in determining whether a clause is broad or narrow, the court must consider whether the parties clearly manifested a desire to limit arbitration to specific disputes. While arbitration is heavily favored, a narrow arbitration clause will only cover an issue that, on its face, falls within the boundaries of the clause, and matters that are merely collateral to those falling within the scope of an arbitration clause are not covered. Here, looking at the factual underpinnings of the claim rather than the legal labels used by the plaintiff, the Court found that Chelsea’s claims regarding the low reimbursements fell within the scope of the narrow arbitration clause, but that its competitiveness claims did not. Because resolution of the

reimbursement claims were distinct from, and would have no preclusive effect on, the competitiveness claims, the Court held that there was no need to stay the competitiveness claims pending the outcome of the arbitration of the reimbursement claims.

Jones v. Halliburton Co., 583 F.3d 228 (5th Cir. 2009).

Holding: Plaintiff's claims arising from an alleged sexual assault fell outside a broad arbitration provision that called for arbitration of all claims "related to" employment.

Background and Analysis: Plaintiff worked for Halliburton/KBR in Baghdad. Plaintiff alleged that one night, she was drugged, beaten, and sexually assaulted by several Halliburton/KBR employees while she was off duty in her barracks bedroom. Plaintiff filed suit against Halliburton/KBR, and Halliburton/KBR sought to compel arbitration under Plaintiff's employment contract, which stated that she agreed to arbitrate "any and all claims . . . related to [her] employment."

The Fifth Circuit held that Plaintiff's claims arising from the sexual assault (for assault and battery, intentional infliction of emotional distress, negligent hiring, retention and supervision, and false imprisonment) were not within the scope of the arbitration agreement. The Court conceded that the analysis was fact-specific and was careful not to hold that sexual assault allegations could never relate to employment. But the Court held that under the facts of the case—where the assault occurred after hours in Plaintiff's bedroom while she was off duty—the arbitration provision's scope stopped at the Plaintiff's bedroom door.