



ARBITRATION'S EMPIRE

Jeff Bleich and Josh Patashnik

This past December, the *DIRECTV Inc. v. Imburgia* decision reinforced a decade-long trend in the U.S. Supreme Court: expanding the realm of arbitration and rejecting state-level legislative or judicial efforts to halt that growth. That trend, as well as the concern among certain legislatures, courts, and advocates about the reach of arbitration, is more than just an interesting legal development. It reveals a sharp tension about the future of arbitration and our nation's public courts.

After several decades in which arbitration issues appeared only rarely on the Court's docket, arbitration matters now come before the Court virtually every term. In particular, the Court has routinely taken up cases in which state courts, most frequently in California, have declined to enforce arbitration agreements against consumers or employees. In each instance (including this term in *Imburgia*), the Court has reversed and sided with the party—usually a commercial entity—seeking to arbitrate, or to have a particular issue resolved by the arbitrator. Indeed, the trend has become so pronounced that Supreme Court practitioners now joke that the most promising way to begin an oral argument is to say: “Mr. Chief Justice and may it please the Court, this is a case in which the California courts denied a motion to compel arbitration.” What accounts for that change, and what does it portend for the future?

The Federal Arbitration Act and the Court's Interpretation

The rise of commercial arbitration in America initially grew out of the Roaring Twenties' enthusiasm for the free market. Although private arbitration agreements had been around for decades, many state courts had refused to enforce them. Those courts doubted the fairness of these contracts and voiced reluctance to allow parties to bargain away their right to court-enforced protections. Critics countered that these state courts simply preferred to

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preserve for themselves a monopoly over the market for binding dispute-resolution services, even when individuals and businesses wanted an alternative.

Congress largely sided with the reformers who wished to expand private arbitration, while also ensuring that courts reserved some power to revoke unlawful or inequitable arbitration agreements. Thus, in 1925 Congress enacted the Federal Arbitration Act (FAA), 9 U.S.C. section 1 et seq., which provides (among other things) that courts must enforce arbitration contracts as written, "save upon such grounds as exist at law or in equity for the revocation of any contract."

For more than half a century, the FAA drew little attention from the Supreme Court, and only civil procedure professors and a handful of practitioners seemed to pay much notice to its FAA jurisprudence. In fact, it was not until the 1980s that the Court resolved even basic ques-

tions about the law. See, for example, *Southland Corp. v. Keating* (1984) (FAA establishes a body of substantive federal law that applies in both federal and state courts); *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.* (1989) (FAA obligates courts to enforce arbitration agreements according to their terms).

Starting about ten years ago, however, the Court began granting a series of one or two FAA cases per term, with decisions that have consistently empowered parties relying on arbitration to resolve their disputes. For example, the Court has held that:

- An arbitrator, rather than a court, must ordinarily resolve a challenge to the legality of a contract with an arbitration provision (*Buckeye Check Cashing, Inc. v. Cardegna* (2006))
- States and courts may not vary or expand on the FAA's exclusive grounds for vacating or modifying an arbitration award (*Hall Street Assocs. v. Mattel, Inc.* (2008))
- Collective-bargaining agreements may legitimately require union members to arbitrate claims against an employer, including statutory antidiscrimination claims (*14 Penn Plaza LLC v. Pyett* (2009))
- A party that authorizes arbitration cannot be compelled to classwide arbitration without its consent, even if civil courts would provide for class treatment and the arbitrators favor that approach (*Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* (2010))
- An arbitrator rather than a court must decide whether preconditions to international arbitration in bilateral investment treaties have been satisfied (*BG Group, PLC v. Republic of Argentina* (2014))

Finally and most recently, in *Imburgia*, the Court considered and reversed a California court's interpretation of a contract as not requiring arbitration. The Court held that although contract interpretation is ordinarily a matter of state law, the FAA prohibits state courts from applying different rules of contract interpretation to arbitration contracts than to other types of contracts, as the California court had done.

The Ongoing Battle over *Concepcion*

On balance, the above cases are relatively uncontroversial. Many were unanimous or close to it, and turned on fairly bland principles of statutory interpretation. The same cannot be said of *AT&T Mobility LLC v. Concepcion* (2011), a case that sent shock waves across the California legal landscape.

In *Concepcion*, the Court considered California's so-called *Discover Bank* rule. That rule held as a matter of public policy that parties to an agreement could not waive class-action relief—either in litigation or in arbitration—because such waivers were unconscionable and thus unenforceable. The rule was not confined to arbitration clauses, but instead preserved California's preference for permitting classwide relief in all forums. Nevertheless, by a five to four vote, the Court held that the FAA preempted the *Discover Bank* rule in the context of arbitration contracts. Specifically, it held that the rule unduly interfered with the FAA's purpose and objective of promoting efficient and informal resolution of disputes through arbitration. Notably, Justice Clarence Thomas, who supplied the fifth vote, acknowledged that he was "reluctantly" concurring in the opinion despite his general opposition to the mushy and malleable "purposes and objectives" preemption test.

Concepcion has generated unusual heat for an arbitration case in part because of its immediate consequences and in part because of its longer-term implications. Defense-side litigators universally hailed *Concepcion* for its immediate effect: reining in what they considered to be plaintiffs' lawyers' abuse of class actions. They recognized that *Concepcion* has the practical effect of foreclosing *any* relief for certain small-dollar-value claims subject to an arbitration clause. As Judge Richard Posner (United States Court of Appeals for the Seventh Circuit) has observed, because no individual or lawyer would undertake the expense associated with private arbitration for a small claim, "the realistic alternative to a class action is not 17 million individual suits, but zero individual suits." The Court's subsequent opinion in *American Express Co. v. Italian Colors Restaurant* (2013), which applied *Concepcion's* reasoning

to class claims brought under federal antitrust law, confirmed that the Court not only understands this possibility, but accepts it as the likely outcome absent new legislation from Congress.

Critics of *Concepcion* not only condemn its practical effect, but more broadly complain that it realizes the very fears of courts and state legislators at the time the FAA was enacted. They see *Concepcion* as a green light for defendants, armed with well-crafted arbitration clauses, to rip off consumers or employees a little bit at a time. They consider it a fundamental threat to the civil justice system as a regulatory mechanism. With more and more employment and consumer agreements now subject to arbitration clauses, the reach of *Concepcion* could prove to be vast. Accordingly, these critics warn that state legislatures and courts should be deeply concerned that their prerogatives will be undermined by companies that rely on arbitration to avoid collective dispute resolution.

Arbitration's Empire Arrives

The strong reaction to *Concepcion* has been compounded by two simultaneous trends relating to the prominence of arbitration: (1) the proliferation of arbitration provisions in everything from clickwrap licenses to multinational treaties, and (2) growing concern by some courts and advocates about how the use of arbitration is damaging the development of public law.

Arbitration is no longer a small outpost at the fringes of the American legal system; increasingly, it *is* the legal system. That is particularly true online, where jurisdictional borders do not exist and contracts are nonnegotiable. It is also true in the international context, where individuals and firms understandably prefer arbitration to litigation in unfamiliar, unpredictable, and potentially biased local courts. Even in ordinary domestic commercial disputes, given the reductions in many court budgets, the ensuing judicial backlog, and the increasing costs of litigation, many companies—for entirely legitimate reasons—have come to favor arbitration over litigation in all of their contracts.

Aspects of arbitration that were less troubling when the process applied only to a modest number of disputes between sophisticated parties who actively chose arbitration may raise far greater concerns when they begin to cover virtually all kinds of disputes. For all of its virtues, arbitration still lacks a number of the basic attributes that define a functioning legal system.

For example, one of the defining features of arbitration is that it permits flexible application of procedural rules, and an arbitrator's judgments are generally unreviewable. While in theory this is what parties have bargained for, many arbitration contracts are not bargained in any real sense. Likewise, the fact that the arbitrator is paid by the parties introduces concerns that do not exist in pub-

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lic courts. There is a widespread perception, reflected in a recent multipart *New York Times* news series, that the arbitrator selection process is rigged in favor of large institutional parties (usually the defendants), since arbitrators have a powerful financial incentive to keep their repeat-litigant private clients happy. Experts and practitioners debate how pervasive that problem is, but the lingering perception of bias taints the reputation of arbitration.

Another potentially serious problem is that, because most arbitration decisions are confidential, they deprive both courts and ultimately parties to arbitration of important, path-setting precedents. In the case of *Concepcion*, entire categories of decision making may disappear. Substantive law develops primarily through the process of adversarial appellate litigation—the exact process that arbitration is meant to supplant. As arbitration grows in popularity and public precedents diminish, how will arbitrators and courts alike provide predictability and clarity to litigants regarding what law will govern their disputes?

The Showdown

The combined impact of these concerns, and particularly of continued opposition to *Concepcion*, seems to be producing a showdown between proponents and opponents of arbitration at both the state and federal levels.

The California Supreme Court held in *Iskanian v. CLS Transportation* (2014) that the FAA does not preempt California law prohibiting the waiver of Private Attorney General Act (PAGA) representative actions for civil penalties in an employment contract. A Ninth Circuit panel reached the same conclusion in *Sakkab v. Luxottica Retail* (2015). The Supreme Court has let that rule stand for now—it denied a cert petition in *Iskanian*—but a new petition is likely to follow in *Sakkab*, assuming the Ninth Circuit does not rehear the case en banc. Although the Supreme Court may ultimately grant review, for now, PAGA will continue to provide an avenue for employment claims to proceed on a collective basis, and its approach conceivably could be extended by statute to consumer claims as well.

Another response to *Concepcion* has been to lower the bar for establishing that a contract is unconscionable as a matter of state law. In *Sanchez v. Valencia Holding Co.* (2015), the California Supreme Court reiterated that unconscionability remains a ground for invalidating an agreement to arbitrate, and also suggested that contracts that are merely “unfairly one-sided” might meet that standard, seemingly a lower bar than had been suggested in other cases. Although the court upheld the arbitration provision at issue in *Sanchez*, other arbitration clauses might produce a different result. Whether such a change to unconscionability law is actually desirable is far from clear, but as long as the new unconscionability standard was applied across the board (rather than just in arbitration cases), the FAA would likely not prohibit it.

Still more far reaching is a proposal currently being considered by the federal Consumer Financial Protection Bureau (CFPB) to ban altogether mandatory arbitration clauses in consumer contracts involving financial products. The proposed rule, which the CFPB has de-

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scribed as being motivated in part by *Concepcion*, could go into effect within a year. It would face an immediate and forceful legal challenge, but could provide yet another route around *Concepcion*.

The Path Forward

All these efforts reflect the high stakes of the showdown over *Concepcion* and arbitration more generally. There is a temptation on the part of some on both sides to push for all-out victory: either to return arbitration to its earlier (marginal) role, or to use arbitration as a way to cut off certain claims altogether. Yet both these visions face major obstacles. The long-term trend toward greater use of arbitration is irresistible—but so is the principle that meritorious civil claims deserve a hearing before an impartial tribunal.

Those dueling realities point toward a more likely future.

The back-and-forth over *Concepcion* and the merits of arbitration will continue, but so will the search for other solutions to the problems that gave rise to that debate. Arbitrators and practitioners may devise ways to make arbitration function more like the real legal system it aspires to be. Judicial reform (such as, for instance, the recent amendments to the Federal Rules of Civil Procedure to address discovery costs) may help lower the cost and duration of litigation. And the inescapable tension in the law between fairness and efficiency will remain with us.

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