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## **Supreme Court: Class wide Arbitration Requires Explicit Consent**

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# Supreme Court: Class Wide Arbitration Requires Explicit Consent

November 19, 2019

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# Overview

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1. The Federal Arbitration Act (FAA)
2. Precedential Supreme Court Cases
3. Recent Supreme Court Decisions Favor Arbitration
4. Potential Implications - Future of the Class Arbitration?
5. Pending Legislation

# The Federal Arbitration Act

# Federal Arbitration Act (FAA)

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- Enacted February 12, 1925
- Provides for judicial facilitation of private dispute resolution through arbitration
  - Both state and federal courts
- Provides for contract-based compulsory and binding arbitration with an award entered by an arbitrator or panel as opposed to a court
  - Once award is entered, it must be “confirmed” by court and reduced to enforceable judgment within a year
  - Parties give up the right to appeal to court on substantive grounds
- An arbitration agreement can be entered into prior to a dispute or after the dispute has arisen

# The FAA – Relevant Provisions

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9 U.S.C. §§ 2, 3, 4, 10

- **Section 2:** “A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”
- **Section 3** provides that a court must stay litigation “upon being satisfied that the issue” is “referable to arbitration” under the agreement.
- **Section 4** states that a court, in response to a motion by an aggrieved party, must compel arbitration “in accordance with the terms of the agreement” when the court is “satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue.”
- **Section 10** provides for back-end judicial review of an arbitrator’s decision if an arbitrator has “exceeded” his or her “powers.”

# Applying the FAA

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- When a dispute arises, the parties sometimes may disagree not only about the merits of the dispute but also on whether their arbitration agreement applies to the particular dispute. **Who decides that threshold arbitrability question?**
- The Act allows parties to agree by contract that an arbitrator, rather than a court, will resolve threshold arbitrability questions as well as underlying merits disputes. This is accomplished in a **delegation clause**.
- However, some Courts of Appeal (including the Fifth Circuit) have determined that the court rather than an arbitrator should decide the threshold arbitrability question if, under the contract, the argument for arbitration is wholly groundless. Those courts have reasoned that the **“wholly groundless” exception** enables courts to block frivolous attempts to transfer disputes from the court system to arbitration.

# Key Scotus Decisions

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- *Dean Witter Reynolds, Inc. v. Byrd*, 105 S.Ct. 1238 (1985)(FAA requires courts to enforce the parties' agreement to arbitrate, even if it leads to piecemeal litigation)
- *KPMG v. Cocchi*, 132 S.Ct. 23 (2011)(FAA “reflects an emphatic federal policy in favor of arbitral dispute resolution)
- *AT&T Mobility LLC v Concepcion*, 131 S.Ct. 2011 (“when state law prohibits outright the arbitration of a particular claim, the analysis is straightforward: The conflicting rules is displaced by the FAA”)
- *Marmet Health Care Center, Inc. v. Brown*, [](2012)(FAA preempts state public policy against predispute arbitration agreements)
- *DIRECTV, Inc. v. Imburgia*, 136 S.Ct. 463 (2015)(arbitration clause prohibiting class arbitration was enforceable under the FAA)
- *Kindred Nursing Centers, L.P. v. Clark*, [] (2018)(FAA applies to contract formation and preempts a state law that singles out arbitration agreements for disfavored treatment)

# Recent Supreme Court Decisions Favor Arbitration

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- *Henry Schein, Inc. v. Archer & White Sales, Inc.*, 139 S. Ct. 524 (2019)(rejected the “wholly groundless” exception to the rule that courts will enforce a “clear” and “unmistakable” delegation clause and reinforced the point that the FAA allows parties to agree that an arbitrator shall decide threshold question)
- *Lamps Plus, Inc. v. Varela*, 139 S. Ct. 1407 (2019)(an ambiguous agreement cannot provide the requisite contractual basis to support a finding that the parties agreed to submit a dispute to class arbitration)
- *New Prime, Inc. v. Oliveira*, 139 S. Ct. 532 (2019)(when a contract includes a mandatory arbitration clause, employees and independent contractors alike can seek court oversight to determine if the “employment” falls within FAA exceptions)

# ***Henry Schein v. Archer & White Sales (2019)***

# Relevant Precedent

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## *Rent-A-Center, West, Inc. v. Jackson*, 561 U. S. 63 (2010)

- The Agreement provided that “[t]he Arbitrator, and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement including, but not limited to any claim that all or any part of this Agreement is void or voidable.”
- Under the FAA, arbitration is a matter of contract, and courts must enforce arbitration contracts according to their terms.
- Parties may agree to have an arbitrator decide not only the merits of a particular dispute but also “‘gateway’ questions of ‘arbitrability,’ such as whether the parties have agreed to arbitrate or whether their agreement covers a particular controversy.”
- An “agreement to arbitrate a gateway issue is simply an additional, antecedent agreement the party seeking arbitration asks the federal court to enforce, and the FAA operates on this additional arbitration agreement just as it does on any other.”

# Relevant Precedent

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Over the last decade, several federal appeals courts — including, the Fourth, Fifth, Sixth and Federal Circuits — invoked a judicially crafted exception to the Supreme Court precedent with respect to delegation, known as the “wholly groundless exception.” These decisions set the stage for two of the most recent Supreme Court Cases dealing with class-wide arbitration.

# Henry Schein – Factual Background

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- Archer & White brought an antitrust suit against Henry Schein seeking money damages and injunctive relief.
- The relevant contract between the parties read:
  - “Disputes. This Agreement shall be governed by the laws of the State of North Carolina. Any dispute arising under or related to this Agreement (except for actions seeking injunctive relief and disputes related to trademarks, trade secrets, or other intellectual property of Pelton & Crane), shall be resolved by binding arbitration in accordance with the arbitration rules of the American Arbitration Association [(AAA)]. The place of arbitration shall be in Charlotte, North Carolina.”
- Invoking the FAA, Schein asked the District Court to refer the matter to arbitration, but Archer & White argued that the dispute was not subject to arbitration because its complaint sought injunctive relief, at least in part.
- Schein contended that because the rules governing the contract provide that arbitrators have the power to resolve arbitrability questions, an arbitrator—not the court—should decide whether the arbitration agreement applied.
- Archer & White countered that Schein’s argument for arbitration was “wholly groundless,” so the District Court could resolve the threshold arbitrability question.

# *Henry Schein* – Procedural History

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- The District Court agreed with Archer & White and denied Schein’s motion to compel arbitration.
- The Fifth Circuit affirmed and held that because Archer & White sought injunctive relief, Schein’s argument that the action was subject to binding arbitration was “wholly groundless” and need not be decided by the arbitrator.
- The Supreme Court granted cert. and rejected all arguments in support of the “wholly groundless” exception.

# Henry Schein – Analysis

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The Court rejected four of Archer & White’s counterarguments:

1. Archer & White’s argument that §§3 and 4 of the Act should be interpreted to mean that a court must always resolve questions of arbitrability had already been addressed and rejected by the Court. Parties may delegate threshold arbitrability questions to the arbitrator, so long as the parties’ agreement does so by “clear and unmistakable” evidence.
  - Under §2, before referring a dispute to an arbitrator, the court determines whether a valid arbitration agreement exists. But if a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator, a court may not decide the arbitrability issue.
2. Its argument that §10 of the Act supports the conclusion that the court, at the outset, should also be able to determine arbitrability was inconsistent with the way Congress designed the Act. It was not the Court’s proper role to redesign the Act.
3. Its argument that it would be a waste of the parties’ time and money to send wholly groundless questions of arbitrability to an arbitrator ignored the fact that the Act itself contains no “wholly groundless” exception. The Court may not engraft its own exceptions onto the statutory text.
4. Its argument that the exception is necessary to deter frivolous motions to compel arbitration overstated the potential problem. Arbitrators are already capable of efficiently disposing of frivolous cases and deterring frivolous motions, and such motions do not appear to have caused a substantial problem in those Circuits that have not recognized a “wholly groundless” exception.

# Henry Schein – Holding

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- Court rejected the “wholly groundless” exception to the general rule that courts will enforce a “clear” and “unmistakable” agreement delegating questions of arbitrability to the arbitrator.
- The exception was inconsistent with the FAA and so this decision reinforced the fundamental point that the FAA governs all agreements to arbitrate and unequivocally allows the parties to agree that the arbitrator shall decide the ‘gateway’ questions of ‘arbitrability.’
- When the parties’ contract delegates the arbitrability question to an arbitrator, a court may not override the contract, even if the arbitrability claim is deemed wholly groundless. The courts must respect the parties’ decision as embodied in the contract.
- The decision is consistent with the Supreme Court’s long-standing position that the FAA must be interpreted broadly in favor of arbitration and that arbitration provisions must be strictly enforced — including those provisions that delegate gateway issues of arbitrability.
- Courts retain a single threshold task before referring a dispute to an arbitrator: determining whether a valid arbitration agreement exists. If a valid agreement exists, and if the agreement delegates the arbitrability issue to an arbitrator, a court may not decide the arbitrability issue.

# *Lamps Plus v. Varela (2019)*

# Relevant Precedent

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## *Stolt-Nielsen S.A. v. Animalfeeds International Corp.*, 559 U.S. 662 (2010)

- Factual Background:
  - Animalfeeds and other customers filed suit against Stolt-Nielsen alleging a “global conspiracy to restrain competition in world market for parcel tanker transportation services.”
  - Animalfeeds and other customers originally filed separate suits in federal district court, but the claims were sent to arbitration pursuant to the parties' arbitration agreements.
  - The agreement read:
    - “Arbitration. Any dispute arising from the making, performance or termination of this Charter Party shall be settled in New York, Owner and Charterer each appointing an arbitrator, who shall be a merchant, broker or individual experienced in the shipping business; the two thus chosen, if they cannot agree, shall nominate a third arbitrator who shall be an Admiralty lawyer. Such arbitration shall be conducted in conformity with the provisions and procedure of the United States Arbitration Act [i.e., the FAA], and a judgment of the Court shall be entered upon any award made by said arbitrator.”
  - The parties agreed that their arbitration agreements were indeed silent regarding the availability of class arbitration, but they disagreed about whether that silence precluded the claims from being arbitrated as part of a class.
  - At issue was whether the Federal Arbitration Act permits arbitrators to impose class arbitration on parties whose arbitration agreements are silent regarding class arbitration.

# Relevant Precedent

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*Stolt-Nielsen S.A. v. Animalfeeds International Corp.*, 559 U.S. 662 (2010)

- Procedural History:
  - Animalfeeds demanded to proceed as a class and an arbitration panel was appointed that determined the language of the clause permitted class arbitration.
  - Stolt-Nielsen petitioned the court to vacate the panel's determination, which the court granted.
  - On appeal, the court reinstated the panel's decision and held that the clause permitted Animalfeeds to proceed as a class, even though the contract was silent on this issue.

# Relevant Precedent

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*Stolt-Nielsen S.A. v. Animalfeeds International Corp.*, 559 U.S. 662 (2010)

- **Holding:**
  - The Court determined that when a dispute involves similarly-situated individuals, a few individuals may conduct the arbitration on behalf of the larger groups only if the parties specifically agree.
  - When parties agree to arbitrate, the question of whether an agreement permits class arbitration is generally left to the arbitrator as opposed to the court.
  - To impose class arbitration on parties who have not agreed is inconsistent with the FAA, which adopts the basic principle that arbitration is a matter of consent not coercion. In the absence of any evidence that the parties agreed to engage in class arbitration, imposing class arbitration would violate that foundational FAA principle.
  - The Court also emphasized that class arbitration is fundamentally different from standard arbitration between two parties. Class arbitration lacks privacy and confidentiality protections, requires the adjudication of the rights of absent parties, and can entail the resolution of extraordinarily high-value claims—a prospect that is particularly risky given the limited judicial review of arbitration decisions. As such, arbitrators cannot presume that a party consenting to the latter would also consent to the former.

# Relevant Precedent

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## *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011)

- Procedural History:
  - AT&T was sued for allegedly engaging in deceptive advertising. The suit became a class action. AT&T asked the district court to dismiss the suit and submit any disputes to individual arbitration.
  - The arbitration agreement was designed to promote small claims arbitration, including the following:
    - AT&T would pay the entire cost
    - The arbitration would take place in the county where the consumer was located
    - Damages were not limited
    - If the consumer received more than AT&T's last written offer, the award would be increased to \$7,500 and the consumer would receive double attorney's fees
  - However, court declined to enforce the agreement, finding that California law prohibits contracts that unfairly exculpate one party from wrongdoing
  - AT&T argued that this doctrine was preempted by the FAA
  - The Ninth Circuit upheld this decision

# Relevant Precedent

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*AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011)

- Holding
  - Class arbitration is fundamentally different from traditional arbitration
  - California rule prohibiting contracts from disallowing class-wide arbitration was preempted by the FAA
  - Impact: arbitration clauses with class waivers were permissible

# Relevant Precedent

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## *Epic Systems Corp. v. Lewis*, 138 S.Ct. 1612 (2018)

- Procedural History
  - Circuit split as to whether the National Labor Relations Act of 1935 (NLRA) permitted employee class action lawsuits
  - Section 7 of the NLRA:
    - Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to **engage in other concerted activities** for the purpose of collective bargaining or other mutual aid or protection
    - Plaintiffs contended that class actions were “other concerted activities”
  - Argument that this provision permitted class arbitration, relying on the “savings clause” of FAA, under which arbitration agreement may be unenforceable “if such grounds as exist at law or in equity for the revocation of any contract”

# Relevant Precedent

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*Epic Systems Corp. v. Lewis*, 138 S.Ct. 1612 (2018)

- Holding
  - Arbitration agreements providing for individualized proceedings are enforceable under the FAA
  - Neither the savings clause of the FAA nor the NLRA override that outcome
  - The “other concerted activities” in the NLRA related to collective bargaining, not dispute resolution

# *Lamps Plus* – Factual Background

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- Mr. Frank Varela brought suit against his employer, Lamps Plus, setting forth a variety of claims on behalf of a putative class of other Lamps Plus employees whose tax information had been exposed in a data breach.
- Varela and the other employees had signed an arbitration agreement as a condition of employment.
  - First, it stated Varela's assent to waiver of "any right I may have to file a lawsuit or other civil action or proceeding relating to my employment with the Company."
  - Second, it included an additional waiver by Varela of "any right I may have to resolve employment disputes through trial by judge or jury."
  - Third, "arbitration shall be in lieu of any and all lawsuits or other civil legal proceedings relating to my employment."
- Lamps Plus moved to compel individual arbitrations pursuant to these agreements.

# *Lamps Plus* – Procedural History

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- The District Court granted Lamps Plus's motion to compel arbitration and dismissed Varela's claims without prejudice. However, it rejected the request for individual arbitration and instead permitted class-wide arbitration.
- Lamps Plus appealed, arguing that the order allowing class-wide arbitration was in error.
- The Ninth Circuit affirmed the district court's decision. It concluded that the Lamps Plus agreement was ambiguous as to class arbitration but, applying California law and the doctrine of contra proferentem (construing ambiguities against the drafter), the court adopted Varela's interpretation permitting class arbitration.
- Lamps Plus sought certiorari, arguing that the Ninth Circuit's decision was contrary to *Stolt-Nielsen* and that it created a circuit split.

# Lamps Plus – Analysis

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- The Court initially restated some of the bedrock principles of the FAA:
  - FAA requires that a court enforce an arbitration agreement according to its terms
  - Any state law principle that obstructs the purpose of the FAA is expressly preempted
  - Under the FAA “arbitration is strictly a matter of consent”
- The Court also clarified that there exists a fundamental difference between class arbitration and “the individualized form of arbitration envisioned by the FAA.”
  - Cited *Stolt-Nielsen* to explain that in individual arbitration, “parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lower costs, greater efficiency and speed, and the ability to choose expert adjudicators to resolve specialized disputes” while on the other hand, “class arbitration lacks those benefits.”
- The Court further reasoned: “Like silence, ambiguity does not provide a sufficient basis to conclude that the parties to an arbitration agreement agreed to sacrifice the principal advantage of arbitration.”
- The doctrine of contra proferentem could not decide the class arbitration question because that doctrine was based on “public policy” rather than any desire to ascertain the true intent of the contracting parties.

# *Lamps Plus* – Holding

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- The court split 5-4, with the majority rejecting the application of the common-law rule that ambiguous contracts are construed against their drafter when the contract in question is an arbitration agreement and the ambiguity concerns whether plaintiff-employees may arbitrate on a class basis.
- Ultimately, the majority held that a court may not infer from an ambiguous agreement that parties have consented to arbitrate on a class-wide basis.

# Implications – The Future of Class Arbitration?

# Lamps Plus Implications

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- After the Supreme Court's decision in Lamps Plus, courts lack the power to compel class arbitration in the absence of an express agreement to submit to class arbitration.
- Silence or ambiguity in an arbitration agreement regarding class-wide arbitration will not be sufficient to permit class-wide arbitration.
- For a court to order class-wide arbitration, the agreement at issue must clearly show that the parties agreed to use that process.
- The Lamps Plus decision has been interpreted by some as win for businesses, which generally prefer individual arbitration because it is cheaper, quicker, and less procedurally complex than class-wide arbitration.

# Future of Class Arbitration?

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- Would a commercial entity would have reason to specify the use of class-wide arbitration in an employment or consumer contract?
- However, the Supreme Court has denied cert. in two cases where the 11<sup>th</sup> circuit determined an arbitration agreement's selection of the AAA rules delegated the class arbitration issue to the arbitrator. (*Spirit Airlines, Inc. v. Maizes*, 899 F.3d 1230 (11th Cir. 2018), cert. denied, No. 18-617, 2019 WL 1231771 (U.S. Mar. 18, 2019) and *JPay, Inc. v. Kobel*, 904 F.3d 923 (11th Cir. 2018), cert. denied, No. 18-811, 2019 WL 1590250 (U.S. Apr. 15, 2019)).
  - The Lamps Plus majority refused to address whether the class arbitration constitutes a “question of arbitrability” for the courts rather than arbitrators to decide
- In circuits following the 11<sup>th</sup> circuit, businesses utilizing standard arbitration agreement language/selecting the AAA's rules will be required to present their arguments against class arbitration to the arbitrator whose decision on the class arbitration issue will be essentially unreviewable in court.

# Application to Ridesharing Company in CA

- A Ridesharing Company has been in dispute with more than 12,500 drivers who have demanded that the Company pay arbitration fees so the drivers could pursue claims in individual arbitration.
  - Claims deal with anything from overtime to mileage reimbursement
- The Company's arbitration agreement with drivers reads:
  - "[t]his Arbitration Provision applies to any dispute arising out of or related to this Agreement or termination of the Agreement"
  - The agreement includes a delegation clause specifying that the disputes subject to arbitration "include without limitation disputes arising out of or relating to interpretation or application of this Arbitration Provision, including the enforceability, revocability or validity of the Arbitration Provision or any portion of the Arbitration Provision. All such matters shall be decided by an arbitrator and not by a court or judge."
- Disagreement as to whether the Company must front the \$18 million in costs that would allow drivers to initiate individual arbitrations
  - Importantly, the amount it would have to pay to go to arbitration with the drivers would be significantly more than it would have paid to settle multiple class actions
  - In March of 2019, the Company paid \$20 million to settle a lawsuit on behalf of 13,600 drivers
- The Company contends that some of the issues involved, including the fitness of the drivers' lawyers, are similar across all cases and thus should be decided in one consolidated proceeding.
- The Company has acknowledged that the already significant expense of arbitration "may become more costly for us, or the volume of arbitrations may increase and become burdensome." "The use of arbitration provisions may subject us to certain risks to our reputation and brand, as these provisions have been the subject of increasing public scrutiny," the Company said. To minimize such risks, it may "voluntarily limit" its use of arbitration.

# Implications - Drafting Tips

# Practical Drafting Tips

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- Be precise in the language of the arbitration clause
- Consider the following:
  - Scope of claims to be arbitrated?
  - Class-wide arbitration?
  - Delegation clause?
  - State Laws?
  - Unconscionability?
  - Payment of filing fee?
  - Forum?
  - Confidentiality?

# Pending Legislation

# Legislation in Congress

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- Pending legislation in Congress that could stop companies and employers from using mandatory arbitration (Forced Arbitration Injustice Repeal Act or FAIR Act)
- Bill would stop companies from forcing customers or employees to sign arbitration agreement

# CA Labor Law

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- New CA Labor Law purporting to prohibit arbitration agreements in the employment context
  - 10/10/19 CA Governor Gavin Newsom signed bill that prohibits employers from requiring employees to waive any right, forum or procedure as a condition of employment (such as an arbitration agreement)
  - Similar bill was introduced in 2018 but Governor Brown vetoed it on the basis that it violated federal law establishing that FAA preempts state law and the states are bound to the Supreme Court's interpretation of the FAA. States cannot prevent mandatory arbitration agreements from being formed.
  - This new law, which is set to take effect on January 1, 2020, is an addition to the Labor Code.
  - This law also prohibits an employer from threatening, retaliating or discriminating against any employee for the same. Any violation of this law will be considered an unlawful employment practice under the California Fair Employment and Housing Act (FEHA).

## Questions?

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