Scalia's Compulsory Binding Arbitration Legacy—Big Business Prevails at the Expense of Consumers, Employees and Small Businesses

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Introduction

This article focuses on compulsory, binding arbitration as a means of avoiding litigation and resolving disputes. Viewed through a political lens, especially after the election of President Trump, it can be argued that arbitration is but a microcosm of the current political environment. In that broader world, one view, usually labeled as "conservative," emphasizes the importance of free markets and the necessity that business be protected from overregulation and frivolous litigation. The other view, labeled "progressive" or "liberal," recognizes the importance of free markets but believes that without significant safeguards the interests of consumers, employees and even small businesses may be put in jeopardy.

Consumers and employees generally would prefer their cases be decided by courts rather than arbitrators. Traditionally, arbitration has been more favorable to business than consumers or employees. These latter groups seek the benefits of court procedures not available in arbitration. Namely, and possibly the most important, court decisions can be reviewed, which is not normally the case in arbitration. Additionally, the potential for consumers and employees to obtain equitable settlements is greater in court proceedings. Given the conservative majority on the United States Supreme Court with its pro-business view, there has been a marked expansion in arbitration in recent years evidenced in particular by three decisions written by late Justice Scalia.[1] This article will discuss those three Scalia decisions and the current expansive arbitration environment they have created.

A short history of arbitration

Arbitration is a widely accepted alternative to court litigation as a means of settling legal disputes. It has become the procedure of choice employed by business to avoid litigation. It is most commonly used in commercial, consumer, and employment contracts. At its best, arbitration can efficiently re- solve even the most contentious disputes; at its worst, it can deprive consumers, employees, and even small businesses of any reasonable opportunity to redress their grievances.

The Federal Arbitration Act (FAA)[2] was passed in 1925. Prior to its passage, federal courts were not inclined to enforce arbitration agreements. For the most part, judges considered this non-judicial process an unwelcomed intrusion into matters that were otherwise within their exclusive purview. The FAA created a new judicial preference in favor of arbitration. Under the FAA, any written contract containing an arbitration provision is valid, irrevocable, and enforceable, except on grounds that exist for the revocation of any contract.[3] Further, the FAA allows federal district courts to stay proceedings where an arbitration clause is at issue, and to compel arbitration where one party fails to comply with an otherwise valid arbitration agreement. Federal courts now uniformly recognize a liberal policy in favor of arbitration agreements.

In the long march of Supreme Court opinions interpreting the reach of the FAA, the arc is clearly in the direction of an expansive view in favor of arbitration. The three decisions discussed here claim that expansive approach will promote arbitration's prime objective of achieving streamlined proceedings and expeditious results. The Court's minority, on the other hand, questions whether this expanded application of arbitration will provide an opportunity for consumers and employees to obtain a fair resolution of their grievances.

Consumers, employees and small businesses versus arbitration

Typically, consumers have little or no real bargaining power to negotiate an arbitration agreement and often may not even be aware that they have entered into one. This type of agreement, where the stronger party writes the contract and the weaker party has little or no power to negotiate or modify terms, is called an adhesion contract. Most such agreements limit the consumer's remedy to an individual one, and through provisions known as class waivers, prohibit arbitration in an aggregate form ordinarily used in class action litigation. When an aggrieved consumer seeks his or her individual remedy, the amount of damages is often too small to economically pursue. Most importantly, without this ability to use an aggregate resolution format, any business that has acquired substantial ill-gotten gains through small individual deceptions cannot be forced to part with them. This, then, unjustly enriches these businesses at the expense of innocent consumers.

Employees too would prefer the benefits of court litigation rather than be forced into arbitration. Like consumers, they fare better in that arena. Similarly, small businesses who, whether or not they require arbitration for their own custom- ers, are often forced into unfavorable arbitration agreements with large business entities. The three Scalia drafted opinions discussed here: *Rent-A-Center, West v. Jackson* (2010);[4] *AT&T Mobility, Inc. v. Concepcion* (2011);[5] and, *American Express Co. v. Italian Colors Restaurant* (2013)[6] present issues related to all these groups. Whether the plaintiff in these cases was a consumer, employee, or small business, the law created is applicable to all groups and has become part of the current arbitration environment.

Each of these cases represents an example of the ongoing conflict between the conservative view and the progressive view. Justice Scalia, on behalf of the majority in all three cases, argued forcefully in favor of compulsory binding arbitration as necessary for the protection of business. The minority opinions, although written by three different justices, lament the law created which they argue will leave aggrieved consumers, employees, and small businesses without sufficient safeguards to ensure they can adequately redress their grievances. We can now turn to a discussion of each of these cases.

The Three Cases

Rent-A-Center, West, Inc. vs. Jackson

The primary question in Rent-A-Center (RAC) was who would decide whether a case should go to arbitration—the court or the arbitrator. Generally, this question depends on whether the focus of the challenge is to the arbitration provision or the entire contract. Ordinarily, if a challenge is made to the validity of an arbitration provision contained in a con- tract, the court would decide that issue. On the other hand, if the challenge is made to the entire contract, the arbitrator would make the decision. Issues related to the validity of the arbitration provision are referred to as "gateway" issues since a negative decision would close the gate to arbitration while a positive one would open that gate.

As expected, consumers and employees challenging arbitration provisions prefer that courts make those gateway decisions; businesses would rather have these decisions made by an arbitrator. Because of this preference, businesses have started to include clauses in their arbitration provisions that delegate gateway determinations to an arbitrator. As a result, the consumer is deprived of an opportunity to challenge these decisions in a court procedure. At the heart of RAC is one of these delegation clauses.

Jackson, the plaintiff in *RAC*, was a former employee of Rent-A-Center, Inc. He sued RAC in federal district court alleging employment discrimination and retaliation. As a condition of employment, he signed both an employment contract and a separate arbitration agreement. This arbitration agreement included a delegation clause providing that "gateway" challenges would be decided by an arbitrator, not a court. Jackson challenged the validity of arbitration agreement on grounds of unconscionability. RAC moved to dismiss the suit and compel arbitration pursuant to the arbitration agreement's delegation clause.

Generally, in cases challenging an agreement to arbitrate there is a presumption in favor of arbitration. However, when the case concerns a delegation clause that takes the gateway decisions out of the hands of the court, the presumption is reversed. To force gateway issues into arbitration, the business must meet the test of showing "clearly and unmistakably" that the parties agreed to submit these gateway issues to arbitration. Proof of that test is nearly impossible when the claim is that the arbitration agreement is unconscionable. An unconscionability challenge basically alleges that the party with superior bargaining power forced the weaker party to agree to a provision particularly unfavorable to that party. One generally does not "clearly and unmistakably" agree to terms heavily stacked against his own interest.

Justice Scalia found a way around this conundrum avoiding the "clearly and unmistakably" test altogether. As discussed above, there is a dual standard whereby challenges to the contract as a whole are decided by the arbitrator but challenges to the arbitration provision are decided by the court. Justice Scalia reasoned that the separate arbitration agreement was in itself a complete contract rather than part of the employment contract. Under that proposition, he concluded that the case should go to arbitration because the plaintiff had not specifically challenged the validity of the one-sentence delegation provision.

> Accordingly, unless Jackson challenged the delegation provision specifically, we must treat it as valid . . .leaving any challenge to the validity of the Agreement as a whole for the arbitrator.[7]

In a vigorous dissent, Justice Stevens drew a sharp distinction between a challenge to an arbitration clause within a contract and this case's standalone arbitration agreement. In his view, where the challenge is to a standalone arbitration agreement, a challenge to the arbitration agreement is necessarily a challenge to the delegation provision contained therein, as they are one and the same.

> Before today, however, if respondent instead raised a challenge specific to "the validity of the agreement to arbitrate"—for example, that the agreement to arbi-

> trate was void under state law—the challenge would have gone to the court. But the Court now declares that . . .[a] party must lodge a challenge with even greater specificity than what would have satisfied (prior decisions). A claim that an *entire* arbitration agreement is invalid will not go to the court unless the party challenges the *particular sentences* that delegate such claims to the arbitrator, on some contract ground that is particular and unique to those sentences.[8]

RAC sets the tone for the other cases to follow. This expansion of the use of delegation clauses to take gateway issues out of the hands of the courts creates a theme of arbitration at all costs. The next case makes that observation more obvious.

AT&T Mobility LLC vs. Concepcion

The issue in *Concepcion* was whether the FAA preempts state law that prohibits the use of class waivers in adhesion contracts with consumers. The California Supreme Court in *Discover Bank v. Superior Court*[9] determined that class waivers in consumer adhesion contracts were unconscionable and against public policy. The Court reasoned as follows:

> . . .But when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party "from responsibility for [its] own fraud, or willful injury to the person or property of another."[10]

The plaintiffs in *Concepcion* claimed that they were induced by a marketing campaign for what was represented to be a "free" cellular phone to enter into a service contract with AT&T. Upon learning that AT&T had charged them sales tax on the full retail value of the "free" phone, plaintiffs filed a class action in a California federal district court. The service contract provided for arbitration of all disputes, and specifically disallowed classwide arbitration. AT&T moved to compel individual arbitration.

Relying on the California Supreme Court decision in *Discover Bank*, the district court denied AT&T's motion and the Ninth Circuit affirmed. The question before the U. S. Supreme Court was whether the provisions of the FAA favoring arbitration preempted California's *Discover Bank* rule. Generally, in a gateway decision where a court is charged with the responsibility of determining whether the agreement is valid or not, it follows state law to make that determination. The issue here then was whether the conservative majority could find a way to avoid applying California law holding certain class waivers unconscionable in order to have the case sent to individual arbitration. As might be expected, the Scalia-led majority found a way to do so.

The majority held the *Discover Bank* rule inconsistent with the primary objectives of the FAA, and therefore, that the FAA preempted that rule. It provided several rationales for its decision. First, the Court determined that the switch from individual to class arbitration sacrifices the principal advantages of arbitration. Individual arbitration, in the Court's opinion, as opposed to class arbitration, allows the parties the benefit of private dispute resolution, including lower costs, greater efficiency, speed, and the ability to choose expert adjudicators to resolve specialized disputes. Second, since class arbitration requires procedural formality it was unlikely that Congress intended to leave the disposition of class procedural requirements to an arbitrator. Third, showing great deference to the concerns of businesses, the majority reasoned that class arbitration greatly increases risk to business because businesses can more easily calculate a cost benefit analysis between the likely errors associated with individual arbitration and the savings realized by avoiding a costly lawsuit. Fourth, the majority was concerned that the potential loss associated with tens of thousands of potential claimants in class arbitration might pressure big business defendants into settling questionable claims.

In Justice Breyer's dissent, the minority argued that California's *Discover Bank* decision was consistent with the language of the FAA and did not provide an impediment to arbitration since it only held certain class waivers, rather than all such waivers, unenforceable. The minority saw no reason to preempt a rule of state law.

> *Discover Bank* sets forth circumstances in which the California courts believe that the terms of consumer contracts can be manipulated to insulate an agreement's author from liability for its own frauds by "deliberately cheat[ing] large numbers of consumers out of individually small sums of money." Why is this kind of decision—weighing the pros and cons of all class proceedings alike—not California's to make?[11]

Addressing an obvious concern for an aggrieved consumer, Justice Breyer asked whether any rational lawyer would have signed on to represent the Concepcions in litigation for the possibility of fees stemming from a $30.22 claim. The clear answer is none. Functionally, *Concepcion* leaves both individual consumers and consumers in the aggregate without a reasonable remedy.

Concepcion is the most dramatic illustration of the Court majority's pro-business/anti-consumer posture. The class action format is a fundamental method for consumers to aggregate individually small losses and force business to disgorge substantial ill-gotten gains. After *Concepcion*, any business that can bind a customer to an arbitration agreement will include a class waiver. Businesses, particularly those that engage in deceptive practices, will clearly benefit at the expense of innocent consumers. We can now turn to the third case of this troika.

American Express Co vs. Italian Colors Restaurant

Italian Colors is another individual versus class treatment case with a different twist—the plaintiff is a business. In some cases the cost of proving a violation of a federal law, especially antitrust law, is so high that it would be prohibitively expensive for an individual to pursue a remedy for such a violation. However, if individual claims can be aggregated in a class for- mat, sufficient funds can be generated to prove a violation for the benefit of all members of that class. *Italian Colors* presents such a scenario in an arbitration context.

> Plaintiff restaurant accepted AMEX credit cards. The standard AMEX merchant agreement contained an arbitration clause requiring all disputes to be resolved by arbitration and included a class waiver. In disregard of the arbitration agreement, plaintiff brought a class action against AMEX for violation of federal antitrust law. AMEX moved to compel individual arbitration. Plaintiff argued that in order to prevail in arbitration, it necessarily would be required to engage the services of an expert witness at considerable cost, 20 times the potential maximum individual damages. Plaintiff further argued that due to the excessive cost, the class waiver effectively denied it the right to pursue its statutory remedy under federal antitrust law. Plaintiff asked the court to invalidate the class waiver.

Citing its decision in *Concepcion* extensively, the Court dismissed plaintiff's claim. The Court reiterated its familiar litany that arbitration is a matter of contract and courts must "rigorously enforce" the terms of an arbitration agreement. Addressing plaintiff's argument that federal courts should be allowed to invalidate agreements that prevent an effective vindication of a federal statutory right, the Court created a distinction between pursuing a statutory remedy and proving that remedy. The principle that an arbitration agreement cannot eliminate a party's right to seek a remedy under federal law:

> . . .would certainly cover a provision in an arbitration agreement forbidding the assertion of certain statutory rights. And it would perhaps cover filing and administrative fees attached to arbitration that are so high as to make access to the forum impracticable. 'It may well be that the existence of large arbitration costs could preclude a litigant ... from effectively vindicating her federal statutory rights.' But the fact that it is not worth the expense involved in *proving* a statutory remedy does not constitute the elimination of the *right to pursue* that remedy.[12]

In yet another strong dissent, Justice Kagan, representing the progressive or liberal view, took objection to the majority's "pursuing versus proving" distinction. The minority opinion forcefully argued that the *AMEX* arbitration agreement, if enforced, would effectively deny a claimant a remedy against an unlawful business practice:

> …The restaurateur wants to challenge the allegedly unlawful provision (imposing a tying arrangement), but the same contract's arbitration clause prevents him from doing so. That term imposes a variety of procedural bars that would make pursuit of the antitrust claim a fool's errand. So if the arbitration clause is enforceable, AMEX has insulated itself from antitrust liability—even if it has in fact violated the law. The monopolist gets to use its monopoly power to insist on a contract effectively depriving its victims of all legal recourse. And here is the nutshell version of today's opinion, admirably flaunted rather than camouflaged: Too darn bad.
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> In short, the agreement as applied in this case cuts off not just class arbitration, but any avenue for sharing, shifting, or shrinking necessary costs. *AMEX* has put Italian Colors to this choice: Spend way, way, way more money than your claim is worth, or relinquish your Sherman Act rights.
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> The FAA conceived of arbitration as a "method of *resolving* disputes"—a way of using tailored and streamlined procedures to facilitate redress of injuries. In the hands of today's majority, arbitration threatens to become more nearly the opposite—a mechanism easily made to block the vindication of meritorious federal claims and insulate wrongdoers from liability.[13]

Italian Colors is yet another example of the Court majority's willingness to elevate form over substance in order to protect big business in the arbitration arena, in this case at the expense of smaller businesses. The Court's manufactured distinction between the existence of a statutory right and the cost of pursuing that right leaves all merchants accepting AMEX credit cards with no right at all.

Conclusion

Compulsory binding arbitration is the method of choice employed by businesses to protect themselves from the costs and uncertainties of litigation. Cases defining the parameters of arbitration represent but a smaller playing field in the battle of conservative versus liberal philosophies. The vigorous majority and minority opinions examined here illustrate the tension between the conservative view of protecting big business and the liberal view of protecting consumers, employees, and even small businesses.

The three conservative majority opinions penned by Justice Scalia demonstrate an ever-expanding approach to arbitration for the benefit of business. In *Rent-A-Center West, Inc. v. Jackson*, the Court expanded the ability of businesses to design arbitration provisions that delegate to the arbitrator decisions which would ordinarily be for a court to decide. In *AT&T Mobility, Inc. v. Concepcion*, the Court sanctioned the use of class action waivers in arbitration agreements even where state law would prohibit them, thereby depriving consumers of their most important tool in redressing individually small claims that can be quite substantial in the aggregate. In *American Express v. Italian Colors Restaurant*, the Court created a distinction between *the right* to pursue a federally protected claim and *the ability* to prove that claim holding that Italian Colors could only pursue its antitrust claim in individual arbitration. Since the cost to pursuing an anti- trust claim in individual arbitration was prohibitive, not only Italian Colors Restaurant but all AMEX customers were effectively denied their rights to pursue antitrust relief. Applied generally, where arbitration agreements contain class waivers and the cost of pursuing an individual remedy far exceeds any potential remedy, plaintiffs are left with no remedy at all.

In each of these cases the liberal minority did its best to stem the stampede toward an ever-expanding arbitration environment that takes cases out of the hands of courts and puts them in the hands of arbitrators. However persuasive the minority might have been, it was to no avail.

With the "substitution" of Justice Gorsuch for Justice Scalia, it seems likely that the presently configured Supreme Court will continue to bend over backward to make sure that cases will go to arbitration rather than being heard by a court. Justice Scalia's compulsory binding arbitration legacy protecting big business at the expense of consumers, employees, and even small businesses is likely to continue for the foreseeable future barring any modifications to the Federal Arbitration Act.[14]

Endnotes

1 An expansion that can be expected to be maintained with the substitution of Justice Gorsuch for Justice Scalia.

2 9 U.S.C.A. § 1, *et seq*.

3 9 U.S.C.A. § 2.

4 561 U.S. 63 (2010).

5 131 S.Ct. 1740 (2011).

6 133 S.Ct. 2304 (2013).

7 561 U.S. at72.

8 561 U.S. at86.

9 113 P.3d 1100 (2005).

10 *Id* at 1110.

11 131 S.Ct. at 1761.

12 133 S.Ct. at 2310-2311.

13 133 S.Ct. at 2313-2320.

14 Prior to the election of President Trump, there was some hope for positive change on the horizon as a study by the Consumer Financial Protection Bureau (CFPB) found that compulsory binding arbitration clauses are detrimental to consumers, suggesting that rules may be necessary to eliminate such clauses in financial contacts. Consumer Financial Protection Bureau, *"CFPB Study Finds That Arbitration Agreements Limit Relief for Consumers*," March 10, 2015, http://www.consumerfinance.gov/newsroom/cfpb-study-finds-that-arbitration-agreements-limit-relief-for-consumers/. Given President Trump's approach to the CFPB and governmental regulations in general, the possibility of new regulations eliminating arbitration clauses in financial contracts is much less likely.