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ALTERNATIVE DISPUTE RESOLUTION

Proposed Arbitration Limitations and the FAA: Are We Headed for a Showdown?

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Special to the Legal

Attorneys representing consumers have for many years sought to escape mandatory arbitration clauses in contracts, arguing that the arbitration system inherently and unfairly favors corporate defendants. In the wake of the 2010 Dodd-Frank Act as well as recent scandals, including revelations of fraud at Wells Fargo Bank, policymakers and public interest advocates have joined the fight against arbitration. While the recent attacks have focused on arbitration clauses in consumer contracts, arbitration clauses in other types of contracts—e.g., employment contracts and insurance policies—could also be challenged. This article will provide a brief summary of prior challenges to arbitration, review recent developments adding fuel to the fire and examine what the future of arbitration may look like.

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Any dialogue about possible restrictions on pre-dispute arbitration agreements must start with the impact the Federal Arbitration Act (FAA), 9 U.S.C. 1, et seq., has on such limitations. The FAA, enacted in 1925, makes arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for revocation of any contract." The FAA applies not only to federal courts; it also precludes states from undermining the enforceability of arbitration agreements, as in *Southland v. Keating*, 465 U.S. 1 (1984).

In the last five years or so, the U.S. Supreme Court has come down strongly in favor of arbitration, reversing several lower court decisions that restricted mandatory, pre-dispute arbitration clauses. In the first case, the court weighed in on California's common-law rule that rendered class arbitration waivers in consumer contracts unenforceable because they are unconscionable, as in *AT&T Mobility v. Concepcion*, 563 U.S. 333

(2011). Acknowledging that the FAA's savings clause preserves generally applicable contract defenses (like the unenforceability of unconscionable contracts), the court ruled the FAA pre-empted the common-law rule because that rule interferes with the arbitration process and serves as an obstacle to the principal purpose of the FAA, namely to "ensure that private arbitration agreements are enforced according to their terms" so as to afford private parties "efficient, streamlined procedures" for resolving their disputes. Two years later, in *American Express Co. v. Italian Colors Restaurant*, 133 S.Ct. 2304 (U.S. 2013), the Supreme Court addressed the question of whether the FAA permits courts to invalidate arbitration provisions on the grounds that they preclude class arbitration of federal statutory claims. The dispute in American Express arose when merchants who accepted American Express cards at their establishments brought a class action lawsuit against the company for violations of the Sherman Act notwithstanding a provision in the parties' service agreements providing there "shall be no right or authority for any claims to be arbitrated on a class action basis." Finding that the class arbitration waiver does not contravene anti-trust laws, the Supreme Court ruled that there was no basis for invalidating the provision barring class actions in this circumstance. Most recently, the Supreme Court issued a ruling that: reinforced the weight of its decision in *Concepcion;* and expressed a commitment to ensuring that state courts evaluate arbitration provisions on "equal footing" with other contracts, in *DIRECTV v. Imburgia*, 136 S.Ct. 463 (U.S. 2015). As with the other cases it confronted, the court reversed the lower court's decision that refused to enforce an arbitration provision as written.

Following on the heels of these Supreme Court cases, the Pennsylvania Supreme Court, in September 2016, issued a ruling in a case that involved both wrongful death and survival causes of action, only the latter of which was subject to mandatory arbitration, in *Taylor v. Extendicare Health Facilities*, 147 A.3d 490 (Pa. 2016). The lower courts denied a motion to bifurcate, which would have allowed the survival action to be arbitrated, ruling instead that the two actions had to be consolidated pursuant to Pennsylvania Rules of Civil Procedure. The Pennsylvania Supreme Court reversed, finding that the FAA pre-empted the rules of civil procedure. Citing several U.S. Supreme Court decisions, the court asserted that, "while state courts have attempted to reconcile their state law contract defenses and public policy protections with the preemptive effect of the FAA, ... the United States has endeavored to compel judicial acceptance of private agreements to arbitrate."

While the American Express decision involved allegations of Sherman Act violations, the Supreme Court did not find the anti-trust statute to be a "contrary congressional demand" that overrides the FAA. Accordingly, the court was not confronted with a federal statute that was in direct conflict with the FAA. However, such a clash may arise in the wake of Congress' enactment of the Dodd-Frank Act of 2010, Pub. L. No. 111-203. Pursuant to that act, which was prompted by the 2008 financial crisis, the federal government prohibited the use of arbitration clauses in mortgage loans and in connection with certain whistleblower proceedings and authorized the Securities and Exchange Commission to regulate the use of arbitration agreements in contracts between consumers and securities broker-dealers and investment advisers. Congress also directed the Bureau of Consumer Financial Protection (CFPB) to analyze and potentially restrict the use of arbitration agreements in connection with other types of financial products and services. Following its study, in 2016, the CFPB issued proposed regulations governing pre-dispute arbitration clauses in certain consumer financial product and services contracts. The regulations, if adopted, would prohibit arbitration clauses that bar consumer class actions in court and require the submission of certain arbitral proceeding records to the Bureau to ensure the proceedings are fair to consumers.

Subsequently, the Federal Insurance Office (FIO), part of the

U.S. Department of the Treasury, published a Report on Protection of Insurance Consumers and Access to Insurance in November 2016. This report included a section in which the FIO questioned the use of mandatory arbitration clauses in insurance contracts just as the CFPB had done for consumer financial products. The FIO expressed concern about the lack of uniformity in state laws regarding the use of arbitration clauses in insurance policies in light of the fact that 24 states have no restrictions on arbitration clauses, 16 states prohibit the enforcement of arbitration clauses in all insurance contracts and the remaining states permit the limitation of arbitration in certain circumstances. While many of these state statutes apply only to personal lines insurance policies, others are not so limited.

If restrictions on pre-dispute arbitration clauses contained in consumer financial products and services contracts are upheld, policymakers and plaintiffs attorneys may look for other ways to chip away at the FAA.

The combination of the CFPB and FIO reports, as well as Wells Fargo's attempts to compel arbitration of disputes involving the use of "sham" accounts, has renewed, and perhaps reshaped, the debate about the use and scope of mandatory arbitration clauses in contracts. Instead of analyzing whether pre-dispute arbitration clauses conform to the FAA under common law, courts will be forced to determine whether the CFPB rules–assuming they survive constitutional challenges—constitute a "contrary congressional demand" under American Express that the FAA cannot circumvent. Notwithstanding the strong U.S. Supreme Court precedent favoring arbitration, even when the disputes involve consumer contracts, if the CFPB's 2016 recommendations become effective, we could see a significant shift in the arbitration landscape. If restrictions on pre-dispute arbitration clauses contained in consumer financial products and services contracts are upheld, policymakers and plaintiffs attorneys may look for other ways to chip away at the FAA. If pre-dispute arbitration restrictions in insurance contracts are implemented in response to the FIO's concerns, additional preemption questions will arise given that states, not the federal government, govern the business of insurance while the FAA is a federal statute. Moreover, while the CFPB and FIO appear to be focusing on consumer contracts and personal lines insurance respectively, might the limitations they seek to impose be extended to contracts between commercial parties?

Many articles have been written about the advantages of arbitration, and it is not the intent of these authors to rehash them. Suffice it to say that sophisticated commercial parties should be permitted to contractually determine the way in which their disputes are to be resolved. The concerns Congress, and by extension the CFPB, has expressed about consumers who are party to contracts of adhesion do not apply to parties of commercial contracts. Yet, it is not farfetched to envision the expansion of restrictions on arbitration agreements where there is any imbalance, real or perceived, in bargaining power. For example, if Congress were to make distinctions between smaller, "mom and pop" type businesses and Fortune 500 companies, it may determine that the smaller commercial parties need similar protection and begin to limit the use of arbitration in certain circumstances in those contracts. Such a result could take us down a slippery slope and make the FAA virtually unrecognizable. For those businesses that use arbitration clauses in their contracts, keeping a close watch on what transpires with the CFPB's proposed rules is a necessity.

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