Rent-A-Center v Jackson

by

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In 2010 the United States Supreme Court issued some important, even dramatic, decisions relating to arbitration law, the most recent being *Rent-A-Center West Inc v Jackson*[1] (*Rent-A-Center*) decided in June 2010, dealing with the allocation of power between court and arbitrator.

The respondent, Jackson, filed an employment-discrimination suit against Rent-A-Center, his former employer, in the Federal District Court. Rent-A-Center moved to compel arbitration based on an arbitration agreement Jackson had entered into with Rent-A-Center in connection with his employment. Jackson opposed the motion, asserting that the arbitration agreement was unconscionable under Nevada law. Rent-A-Center argued that the issue of unconscionability was to be decided by the arbitrator.

The arbitration agreement had been entered into as a separate document from Jackson's contract of employment, and the claim of unconscionability was asserted with regard to the arbitration agreement itself, not any term of employment. The arbitration agreement contained a clause *specifically* delegating to the arbitrator the power to resolve challenges to the enforceability of the arbitration agreement.

In *Rent-A-Center*, the court once again showed its strongly supportive policy towards arbitration with a new and surprising elaboration of the "separability" doctrine of *Prima Paint Corp v Flood & Conklin Mfg Co*[2] to create a new rule of separability of specific clauses *within* the arbitration agreement. Justice Scalia's opinion, in which Justices Roberts, Thomas, Alito and Kennedy joined, separates the clause delegating to the arbitrator the competence to decide on the enforceability of the agreement, and thereby decide his own jurisdiction, from the rest of the arbitration agreement, and rules that in order to avoid submitting the issue of unconscionability to the arbitrator, the party challenging arbitration must object, not to the arbitration agreement as a whole, but to that specific delegation clause. Since Jackson had not specifically attacked the delegation of this power of decision to the arbitrator as unconscionable, he lost his effort to have the issue of unconscionability decided by the court: it was for the arbitrator.

Justice Stevens wrote a dissent in which the "liberal" wing of the court, Justices Breyer, Ginsburg and Sotomayor, joined. Justice Stevens called the decision "fantastic", in an obviously pejorative sense.

What does *Rent-A-Center*, and its "fantastic" ratio decidendi, represent in American arbitration jurisprudence? Let's put it in context.

The United States Supreme Court has made itself the ultimate source of United States arbitration law by its decisions over the years. The Federal Arbitration Act (FAA),[3] as construed and glossed by the Supreme Court, has become the basic United States statute

[1] 561 U.S. ___, 130 S.Ct. 2772 (2010).
[2] 388 U.S. 395 (1967).
[3] 9 US Code §§1–16.

governing arbitration. It pre-empts inconsistent state law[4] and applies to the full extent of Congress' power to legislate regarding commerce,[5] so that there is virtually no category of dispute which is not arbitrable.[6]

Many consumer advocates, state courts, federal judges, state governments, members of Congress and legal scholars alike have been increasingly critical as the court's jurisprudence has relied on pre-emptive use of the FAA to enforce arbitration agreements in contracts of adhesion, that is, in employment contracts, and contracts between corporations and their consumer customers. It has been difficult, however, to find ways to get around the Supreme Court's doctrine that the FAA pre-empts state law which is contrary to its purposes. One avenue for avoiding arbitration clauses, however, is found in the wording of the FAA itself. Section 2 of the FAA renders agreements to arbitrate valid and enforceable "save upon such grounds as exist at law or in equity for the revocation of any contract". Such grounds include unconscionability[7] as well, for example, as fraud or duress. The Supreme Court has recognised that such grounds are bases for challenge of arbitration agreements, provided that arbitration agreements are held to the same standard as contracts generally.[8]

A noticeable trend has developed for parties not wishing to arbitrate to raise state contract law challenges to the arbitration clause, and unconscionability has been the most common basis for such challenges.[9] Under the *Prima Paint* doctrine,[10] so long as the challenge was to the arbitration clause and not to the contract as a whole, such challenges are largely decided by courts.

As a general matter, unconscionability is difficult to establish: "Most claims of unconscionability fail."[11] However, success rates for claims of unconscionability involving arbitration clauses have been extremely high: in one study, 75 per cent![12]

Probably because of the tension involved in overruling local courts in matters of state law, the Supreme Court has not taken cases in which lower courts found arbitration clauses to be unconscionable or otherwise invalidated them, purportedly based on grounds of general application for the invalidation of contracts.

[4] *Southland Corp v Keating*, 465 U.S. 1 (1984).

[5] *Allied-Bruce Terminix Companies Inc v Dobson*, 513 U.S. 265 (1995).

[6] Arbitrable issues include anti-trust claims, *Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc*, 473 U.S. 614, 628–640 (1985); the Securities Acts, *Scherk v Alberto-Culver Co*, 417 U.S. 506, 511–520 (1974); most employment contracts, *Circuit City Stores Inc v Adams*, 532 U.S. 105, 109 (2001); statutory age discrimination claims, *Gilmer v Interstate/Johnson Lane Corp*, 500 U.S. 20, 35 (1991) (expanded by lower courts to all forms of employment discrimination, e.g. *EEOC v Luce Forward Hamilton & Scripps*, 345 F.3d 742, 748–749 (9th Cir. 2003)). The court has held that the FAA pre-empts a California statute voiding contracts to arbitrate wage disputes: *Perry v Thomas*, 482 U.S. 483 (1987). Curiously, however, an amendment to federal law reversed the narrow result in *Mitsubishi Motors*, since pre-dispute arbitration clauses are no longer enforceable against automobile dealerships: 15 US Code §1226 (2002).

[7] An early English case defined unconscionability as a bargain "such as no man in his sense and not under a delusion would make on the one hand, and as no honest and fair man would accept on the other; which are unequitable and unconscientious bargains; and of such even the common law take notice": *Earl of Chesterfield v Sir Abraham Janssen* [1750] 28 E.R. 82 Ch. at 100. A New York court said, "The law has developed the concept of unconscionability so as to prevent the unjust enforcement of onerous contractual terms which one party is able to impose under [*sic*] the other because of a significant disparity in bargaining power": *Rowe v Great Atlantic & Pacific Tea Co*, 46 N.Y.2d 62, 69, 385 N.E.2d 566, 412 N.Y.S.2d 827 (1978).

[8] *Perry v Thomas*, 482 U.S. 483 (1987) at 492–493; see also *Doctor's Associates Inc v Casarotto*, 517 U.S. 681, 687 (1996). However, the court has recently heard argument in a case challenging California's rule that arbitration agreements barring class action arbitrations by consumers are unconscionable: *AT&T Mobility LLC v Concepcion*, No. 09-893, argued November 9, 2010.

[9] In a study reported by A.-A.P. Bruhl, "The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law" (2008) 83 N.Y.U. L. Rev. 1420, the number of claims of unconscionability regarding arbitration clauses increased from near zero to around 80 per year in the period 1994 to 2007, and the percentage of court cases involving arbitration in which a claim of unconscionability is raised increased likewise in the same period from almost zero to 18 per cent.

[10] *Prima Paint Corp v Flood & Conklin Mfg Co*, 388 U.S. 395 (1967).

[11] J.M. Perillo, *Corbin on Contracts*, rev. edn (Charlottesville, VA: Lexis Law Publishing, 2002) §29.4.

[12] L.A. DiMatteo and B.L. Rich, "A Consent Theory of Unconscionability" (2006) 33 Fla. St. U.L. Rev. 1067.

Rent-A-Center is therefore very significant in the domestic United States setting. By finding a doctrinal way to refer the decision on unconscionability to the arbitrator, the court was able to decide the case based on the FAA, and at the same time trump the use by lower courts of the doctrine of unconscionability and similar state law rules to frustrate the court's strong policy in favour of arbitration.

It may be anticipated that from now on clauses giving the arbitrator power to decide its own jurisdiction similar to that before the court in *Rent-A-Center* will be widely adopted by US lawyers drafting arbitration agreements. Indeed, many arbitration rules already expressly provide for the arbitral tribunal's power to determine its jurisdiction,[13] which rules are normally regarded as forming part of the arbitration agreement providing for their application.

It remains to be seen whether current or future legislation may modify this result. The Dodd-Frank Wall Street Reform and Consumer Protection Act[14] (Dodd-Frank) became law in July 2010. Dodd-Frank creates a Bureau of Consumer Financial Protection (BCFP), with jurisdiction over consumer contracts for the sale of financial products and services. BCFP will be authorised to ban or regulate pre-dispute arbitration clauses in contracts under its jurisdiction.[15] Also, under Dodd-Frank the US Securities and Exchange Commission will have authority to ban or regulate pre-dispute arbitration agreements in contracts between customers and broker-dealers.[16] In the last Congress a bill called the Arbitration Fairness Act was introduced which would have disallowed binding pre-dispute arbitration clauses altogether in consumer, employment, franchise and statutory civil rights cases. Given the new alignment in the House of Representatives in 2011, such legislation is unlikely to go anywhere.

What may be the relevance of *Rent-A-Center* to international arbitrations?

Where a challenge is made to an agreement based on fraud in the inducement, time bar, etc., not a challenge to the arbitration agreement as such, *Rent-A-Center* will be irrelevant and the matter will be referred to the arbitrator on the authority of *Prima Paint*. While there are many cases of US courts referring parties to arbitration under the New York Convention,[17] if a party alleges that there is no arbitration agreement and brings forward at least some supporting evidence, resolution in court in the first instance is the rule: the issue must be tried.[18] This rule seems to be applied without reference to whether the case is international or domestic.[19] Cases both domestic and international following this rule have been mentioned by the Supreme Court with approval more than once.[20] Therefore, where issues are raised regarding the authority of the representative signing the agreement, the mental capacity of

[13] See, e.g. American Arbitration Association (AAA) Commercial Rules r.7 and International Arbitration (IA) Rules art.15; International Commercial Court (ICC) Arbitration Rules art.6(2); London Court of International Arbitration (LCIA) Rules art.23(1); CPR International Institute for Conflict Prevention (CPR) Rules r.8; Judicial Arbitration and Mediations Services, Inc. (JAMS) Rules r.11(c).

[14] Pub.L. 111-203, H.R. 4173 (became law July 21, 2010).

[15] Dodd-Frank §1028. Strictly speaking the law mandates a study of such pre-dispute arbitration clauses, potentially to be followed by bans or restrictions.

[16] Dodd-Frank §921, adding 15 USC §78o to the US Code.

[17] E.g. *Scherk v Alberto-Culver Co*, 417 U.S. 506, 511–520 (1974); and *Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc*, 473 U.S. 614, 628–640 (1985). See also *Francisco v Stolt Achievement MT*, 293 F.3d 270 (5th Cir. 2002); *Smith/Enron Cogeneration Ltd Partnership Inc v Smith Cogeneration International Inc*, 198 F.3d 88 (2nd Cir. 1999); *Standard Bent Glass Corp v Glassrobots Oy*, 333 F.3d 440 (3rd Cir. 2003).

[18] E.g. *Interocean Shipping Co v Nat'l Shipping & Trading Corp*, 462 F.2d 673 (2d Cir. 1972). Such trial can be by jury if requested by either party: 9 USC §4.

[19] *Par-Knit Mills Inc v Stockbridge Fabrics Co Ltd*, 636 F.2d 51 (3d Cir. 1980), a purely domestic case, which, however, cited *Interocean Shipping Co v Nat'l Shipping & Trading Corp*, 462 F.2d 673 (2d Cir. 1972), and in turn is cited in *Sandvik AB v Advent Int'l Corp*, 220 F.3d 99 (3d Cir. 2000), an international case; *Three Valleys Mun. Water Dist v EF Hutton & Co*, 925 F.2d 1136 (9th Cir. 1991), a domestic case, is often cited in the international decisions.

[20] *Buckeye Check Cashing Inc v Cardegna*, 546 U.S. 440, 444, footnote 1 (2006). The very recent opinion in *Granite Rock Co v International Brotherhood of Teamsters*, 561 US __, 130 S.Ct. 2847, slip opinion at 6 (2010), a domestic case, cites this passage in *Buckeye* with approval.

a party, whether a meeting of the minds was reached and a host of other potential issues going to the very existence of a contract, *Rent-A-Center* will be irrelevant and courts will resolve the issue.

It will only be when there is a challenge to the enforceability of the arbitration clause itself that *Rent-A-Center* will come into play. Then, when the arbitration agreement clearly assigns power to the arbitrator to determine its own jurisdiction, *Rent-A-Center* may make a difference. Unless the challenge is to that delegation itself, the arbitrator will decide such issues as the scope of the clause, defences like unconscionability and like matters. Given that most arbitration rules do assign power to the arbitral tribunal in this way, the impact therefore could be significant. Since the result will be a move in the direction of greater deference to the arbitral tribunal, the impact could be helpful to the international arbitration process in international cases in the United States, and bring practice into closer conformity with that in other countries.