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CONFLICT MANAGEMENT

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Drafting Principles for Class Action Waivers in Arbitration Agreements: Maximize Your Odds of Success

By Stephen J. Newman Esq.

Why Have a Class Action Waiver?

Federal law and many states encourage alternative dispute resolution of private civil disputes.[1] Among other things, arbitration permits less formal, more streamlined, and often fairer and less wasteful resolution of civil disputes. Moreover, by directing civil litigation toward a private setting, arbitration enables public judicial resources to be used for criminal or other proceedings in which arbitration is not an option (such as juvenile dependency, mental health, or public benefits matters).

Additionally, arbitration is designed to be a speedy private proceeding, wherein procedural and evidentiary rules are designed to allow participants to more easily tell the arbitrators their own stories based on specific facts from their perspective. At a fundamental level, however, arbitration is inconsistent with class action adjudication of disputes, which requires assumptions to be made about thousands of unnamed parties so that one-size-fits-all legal and factual determinations can be made. Consequently, some of the efficiencies of arbitration may be lost if the complex and time-consuming elements of class actions are engrafted onto the arbitration process.

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To Arbitrate or Not to Arbitrate

By Jamie Dokovna Esq. and Luba Greenwood Esq.

Earlier this year, the Supreme Court decided two cases that will likely impact the future role of arbitration as a means for dispute resolution. This article will review and analyze each of these decisions and their likely impact on the alternative dispute resolution landscape.

Hall Street Associates, LLC v. Mattel, Inc.

On March 25, 2008, in *Hall Street Associates, LLC v. Mattel, Inc.*,[1] the Supreme Court held that the grounds to vacate or modify arbitration awards set forth in the Federal Arbitration Act, 9 U.S.C. §§ 1, et seq. (FAA) were exclusive, thereby prohibiting parties to a contract calling for arbitration to seek to expand the bases for judicial review of an arbitral award.

The underlying dispute between the litigants, Mattel, Inc. (Mattel) and Hall Street Associates, LLC (Hall Street), arose

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SECTION of LITIGATION
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Message From the Editors


David B. Collier


Annette C. Escobar


Manjit S. Gill

This month we welcome a new cochair to the Alternative Dispute Resolution Committee—Lori Sochin. Prior to this new role, Lori served as the chair of the programs subcommittee from 2005 until presently. Lori is a partner at Greenberg Traurig, LLP, in Miami, Florida. She represents clients in a wide range of business litigation matters in the state and federal courts of Florida. She has experience representing corporations, individuals, and government agencies in disputes involving breach of contract; business torts; insurance coverage; probate, estate, and trust matters; and in all phases of litigation, from complaint through trial. Lori also has extensive alternative dispute resolution experience.

In addition to welcoming a new cochair, our committee newsletter, *Conflict Management*, has a new design and layout beginning with this issue. Gone are the days of tedious layout and adjustments. Working on our publication just got a whole lot easier, so if you were thinking of becoming a contributor or if you are interested in a seat on the editorial board, getting involved is even simpler now. For more information, contact any of the editors on the editorial board.

This edition of our newsletter brings interesting articles about arbitration issues covering non-signatories to an arbitration agreement, class action waivers in an arbitration agreement, and litigation issues for class action waivers. We also have an article on collaborative divorce as an alternative to the more common and destructive contested divorce proceeding.

Every quarter, we send you the latest news, helpful guides, resources, and network connections for everything relating to all forms of alternative dispute resolution. The greatest resource we have to draw our material from is the membership of this committee. If you would like to write an article or if you have a subject you are interested in seeing addressed, please contact us at aescobar@astidavis.com or manjjas@hotmail.com.

Calling All Writers!

Would you like to contribute an article to ***Conflict Management***? We are always looking for articles that cover the many areas of interest to our readers, including arbitration, mediation, summary jury trials, and effective settlement and negotiation techniques. Send your article or query to **sachdeva@staff.abanet.org**, or call Anna Sachdeva with your idea at **312/988-5736**.

Message from the Chairs

We look forward to another productive year in the Alternative Dispute Resolution Committee. With the ongoing turmoil in the markets, alternative dispute resolution is as important as ever as litigants look to cut legal costs and resolve disputes more efficiently. We have a great year of programs and projects planned to benefit you—our members—and your practices. One focus this year is to keep you up-to-date on the various legislative efforts to amend the Federal Arbitration Act and the judicial decisions impacting it.

We encourage you all to join us at the Section of Litigation Annual Conference, which will be held in Atlanta, Georgia, on April 29 through May 1, 2009. Mark your calendars now! For those of you who have attended the Section Annual Conference before, there are some exciting changes coming to the format of this meeting. And for those of you for whom this will be your first Section Annual Conference, prepare yourself for two days jam-packed with numerous CLE and networking opportunities. In addition to daily plenary sessions on cutting-edge ligation topics, there will be 63 one-hour programs grouped into themed tracks.

Our committee is sponsoring several CLE programs on diverse topics, including how to overcome psychological barriers when negotiating disputes, developing skills in conducting discovery and presenting evidence in an arbitration context (as opposed to in a courtroom), the latest information on judicial review of arbitration rulings post-*Hall Street Associates, LLC v. Mattel, Inc.*, and timely information on class actions in arbitration. Like we said, jam-packed. The Section Annual Conference is the place for the most informative, practical, and significant issues affecting your ligation practice. We look forward to seeing you there.

In the meantime, we encourage all of you to become actively involved with the Alternative Dispute Resolution Committee. We have opportunities for you to write for our newsletter or contribute to the committee website at www.abanet.org/litigation/committees/adr. If you have ideas for CLE programs for future conferences or teleconferences, we would love to hear them. There are opportunities to become more involved in the leadership of our subcommittees too. We look forward to hearing from you.


Lori Sochin


Edward M. Mullins

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Informed Consent: Divorcing Couples Have Options

By Debra C. Ruel Esq.

Are divorce clients' interests being well-served if the process they enter into is selected by the attorney they choose? Family law practitioners should make it their business to familiarize themselves with the process options available to a divorcing spouse in order to fully counsel the client. Not every client presents with the same needs and goals. A client has the right to determine which process he or she prefers, and not necessarily the process preferred by the attorney with whom the client happens to consult.

Over the past decade, addressing the needs of high-conflict couples and the incidents of domestic violence between warring couples has preoccupied the family court system. Is the adversarial model of litigation contributing to the conflict? Is a model that pits one parent against the other in evidentiary hearings likely to bode well for the couple co-parenting in the future? Are we stuck with the traditional system?

Prospective divorce clients should be fully informed of all of the options available to them when confronted with divorce or separation: mediation, collaboration, and litigation. In a medical setting, the doctrine of informed consent has been long established. The patient, who may be traumatized by a life-threatening illness, is entitled to a description of the procedure, the risks associated with each procedure, and all reasonable alternatives. The patient is entitled to make an informed decision, weighing all of the relevant factors as set forth by the medical care provider. A particular physician's lack of expertise with regard to a certain procedure does not excuse the need to disclose to the patient all available information. The divorce client should be entitled to no less than a full explanation of all alternatives.

Debra C. Ruel

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During the collaborative process, the couple learns how to discuss areas of disagreement without "going into battle."

An initial consultation with a client seeking divorce should always include a description of the various modalities accepted by the court system. First, a client may choose to represent himself or herself in the process as a pro se party. The client may go to a court service center for a "do-it-yourself divorce kit." There the client will be assisted by specially trained, often bilingual, court staff. The client will be guided through the process from service of the complaint to requesting fee waivers to final judgment. In family court, the prevalence of the self-represented party is much more common than most attorneys believe.

Second, a client may participate in mediation with a neutral attorney-mediator who does not file an appearance or represent either client. The better practice for the client in mediation is to have "consulting counsel" review the final agreement and/or give legal advice to assist the client throughout the mediation process. This process is well-suited to many couples, especially where all of the relevant financial information is readily available to, and understood by, each spouse. The couple usually shares the cost of one mediator rather than each spouse retaining an individual attorney, and consulting counsel is often paid on an "as-needed basis." Mediation is not only cost-effective, but it also "teaches" the couple how to discuss areas of disagreement in a positive, solution-oriented manner, which very often carries on post-divorce.

The third modality is known as the collaborative process, which involves a "no court pledge" and resolution of issues during a series of four-way meetings. Each client is represented in the process by collaboratively trained counsel of his or her selection. Often, ancillary professionals, such as forensic accountants and child psychologists, are brought into the process to utilize their specialized knowledge to generate solutions for the couple. Once again, as in mediation, the couple participates in positive problem-solving methods to reach an agreement that each party has helped create and understands. During the collaborative process, the couple is actively encouraged to gather the necessary factual information, raise issues of concern, describe their needs, concerns, and goals, and generate solutions to the problems.

It is important to note that because the case is resolved through four-way meetings, all communication is transparent: Everyone hears the same thing at the same time. A couple will experience the same process in mediation. However, during the collaborative process, the client is assisted by counsel at every meeting. Most importantly, the couple learns how to discuss areas of disagreement without "going into battle." Compared to litigation, the collaborative process is cost-efficient, as there is no "downtime" waiting to be heard in court or to be seen by a family relations officer. At every meeting, the couple's needs and issues are discussed and addressed.

Finally, there is the traditional litigation model. The parties hire attorneys who communicate with their respective clients and with each other. They are prohibited from communicating in any manner with the adverse client. When four-way meetings are held, each side comes into

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Key Considerations for Litigating Class Action Waivers Within Arbitration Agreements

By Michael M. Giel Esq.

While litigation regarding various provisions within arbitration agreements has become increasingly common, virtually no provision has inspired as much debate as the class action waiver. This waiver provides that one or both of the parties to an agreement irrevocably waives any right to pursue relief through a class action, whether through litigation or arbitration. The use of such waivers may reduce a company's potential exposure to class suits, and thereby reduce its potential litigation costs and operating expenses. Class action waivers may also discourage consumers' pursuit of relief where relatively small sums are involved, no matter how meritorious the consumers' claims, and thereby insulate companies engaging in wrongful conduct from facing liability for their actions. The validity and effect of a class action waiver is usually determined on a case-by-case basis.

Whatever the surrounding facts and circumstances, the presence of a class action waiver within, or in conjunction with, an arbitration provision invites litigation over the waiver's validity. Precedent within a given jurisdiction plays a substantial role in determining whether a certain class action waiver is enforceable, but broad lessons may be gleaned from various recent decisions across the country addressing class action waivers. Though extensive discussion of specific cases is beyond this article's scope, common recurring themes provide an outline of considerations for counsel preparing to argue for or against a class action waiver's enforceability. The underlying and often overlapping considerations concern questions regarding choice of law, procedural unconscionability, substantive unconscionability, and vindication of legal rights.

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The second half of "Key Considerations for Litigating Class Action Waivers Within Arbitration Agreements" will appear in the Spring 2009 issue of *Conflict Management*.

Choice of Law

Federal law determines whether an issue governed by the Federal Arbitration Act (FAA) may be referred to arbitration, and "[q]uestions concerning the interpretation and construction of arbitration agreements are determined by reference to federal substantive law."[1] The FAA provides that written agreements to arbitrate are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[2] Notwithstanding the import of federal law, state law occupies a crucial role in evaluating the validity of a class action waiver. Contract defenses under state law, such as fraud, duress, or unconscionability, may apply to invalidate arbitration agreements if the applicable law arose to govern issues such as the validity, revocability, and enforceability of contracts in general.[3] As courts frequently note, particularly when rejecting arguments that the FAA preempts the court from invalidating class action waivers on state law grounds, the federal policy favoring arbitration merely places arbitration agreements on the same footing as other contracts, rather than placing arbitration agreements in a superior position.[4]

With the understanding that state law plays a role in determining the class action waiver's validity, choice-of-law questions become vitally important. If you are defending a class action waiver in, say, California, and no other state's law applies, you may rest assured that the court will hold that your class action waiver is unenforceable. Conversely, if you are challenging a waiver's validity in California, but cannot show why California has a materially greater interest than the state identified in the choice-of-law provision to which your client had agreed, you may unexpectedly find that the class action waiver remains quite enforceable.

Parties are generally free to structure their arbitration agreements as they see fit, and this freedom generally encompasses choice-of-law provisions within arbitration agreements.[5] Most states have adopted section 187 of the Restatement (Second) Conflict of Laws, which generally provides that choice-of-law provisions within contracts will be enforced unless either (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or (b) application of the law of the chosen state would be contrary to a fundamental policy of a state that has a materially greater interest than the chosen state in the determination of the particular issue.[6]

Consider a situation where the defendant relies on a choice-of-law provision selecting Virginia law, but the plaintiff, a Virginia resident, seeks the application of New Jersey law, the state where the case was filed. Applying section 187, the court must: (1) "analyze whether Virginia has 'no substantial relationship' to the parties or the transaction"; (2) "decide which state has a 'materially greater interest'"; and (3) if it determines New Jersey has a materially greater interest, the court "must analyze whether applying Virginia law, as the law named in the parties' choice-of-law clause, would be contrary to a fundamental public policy of New Jersey."[7]

Substantial Relationship

What constitutes a "substantial relationship" for evaluating the state's relationship

to the parties or the dispute? Any number of characteristics may suffice. A plaintiff may have resided within the state when his telephone services agreement was formed and may possess various phone numbers within the state from which he makes and receives telephone calls.[8] Courts will readily find a substantial relationship where the defendant corporation resides within the state selected in the choice-of-law provision.[9] Establishing that a state has a substantial relationship to the parties or transaction is generally straightforward.

Materially Greater Interest

On the other hand, it is often more difficult to show that the "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state." Demonstrating that a state has a "materially greater interest" is no light burden.[10] Consider the conclusion reached by the Third Circuit in *Gay v. CreditInform*: The Pennsylvania resident plaintiff sought the application of Pennsylvania law and argued that the parties' choice of the laws of Virginia, where the defendant corporation resided, should not be enforced. The fact that each state had a material interest in the parties or transaction did not suffice to show "materially greater interest."

> Virginia . . . has a "substantial relationship" to [the service provider]. Inasmuch as we see no reason to conclude that Pennsylvania "has a materially greater interest" in the enforceability of the arbitration agreement, or that applying Virginia law to determine whether it should be enforced "would be contrary to a fundamental policy" of Pennsylvania, under Pennsylvania's choice-of-law rules we are satisfied that there is no reason not to honor the parties' choice of Virginia law in considering the unconscionability claim. Though it certainly is true that Pennsylvania has an interest in protecting its consumers, we cannot say that Virginia has a lesser interest in protecting businesses located in it. Thus, even if we adopt [plaintiff's] position that the arbitration provision is advantageous to [the service provider], we see no reason not to honor the parties' choice of Virginia law to govern the terms of use of the Agreement.[11]

Nevertheless, some courts' formulations of the "materially greater interest" standard leave additional room for resourceful counsel to argue. In *McGinnis v. T-Mobile USA, Inc.*, a federal district court in Washington addressed a similar choice-of-law question and explained why Georgia law, rather than Washington law, applied to a Georgia plaintiff's claims:

> The issue is not whether Washington has a materially greater interest in using the Washington [Consumer Protection Act] to control the actions of its corporate citizens in Georgia than Georgia has in protecting its resident consumers under the Georgia [Fair Business Practices Act]. Rather, it is whether Washington has a materially greater interest than Georgia does in determining what type of arbitration provisions are valid in a contract drafted in Washington by a Washington corporation, but entered into in Georgia by a Georgia citizen. The Court finds that Georgia's interest in determining the rights of its citizens in contracts with out-of-state actors outweighs whatever interest Washington has in regulating contracts its citizens enter into abroad.[12]

It is difficult to show that applying a chosen state's laws are genuinely contrary to a fundamental policy of the plaintiff's preferred state's laws.

Here, plaintiffs could not satisfy the heavy burden of establishing that Washington had a materially greater interest than Georgia, and the court declined to consider whether Washington had a fundamental policy against defendant's arbitration clause.[13] But, unlike the Third Circuit's discussion in *Gay,* which placed an equal footing on the respective states' interests in protecting their resident consumers and their resident businesses, the Western District of Washington's choice of language may be read to prioritize the state that occupies the position of protector of its resident consumers.

Another aspect of *McGinnis* emphasizes the importance of attention to detail when preparing choice-of-law arguments. Though the district court addressed the agreement governing plaintiff Johnson as "one entered in Georgia by a Georgia citizen," its opinion had stated that "Ms. Johnson signed up for T-Mobile service in Florida and later moved to Georgia."[14] This is an important detail. Just such a distinction arose in *Kaltwasser v. Cingular Wireless LLC*, where the defendant sought the application of Virginia law to a dispute concerning the plaintiff who entered into the agreement while in California, but apparently resided in Virginia at the time the action was filed.[15] Because the agreement provided that the law of the state of the consumer's billing address would govern the agreement, and because Virginia law is far less hostile to class action waivers than California law is, defendant sought application of Virginia law.[16] But the court held that Virginia had no substantial relationship with the parties or dispute: "While Virginia is the state in which [plaintiff] currently receives his wireless service bills, it is not the state in which the contract was formed, nor is it the state under whose laws the dispute arises."[17]

Conflict with Fundamental Policy

Additional language in *Kaltwasser*'s discussion of the second prong could be misapplied. The court stated that Virginia law disfavors class actions and therefore conflicted with California public policy, which had "declared a strong interest in applying [its public] policy to contracts formed within the state."[18] Accordingly, "[b]ecause Virginia likely would not find a contractual provision precluding a class action to be unconscionable, the application of Virginia law would contravene directly California's strong public policy."[19] Perhaps because the court had already concluded that Virginia bore no substantial relationship to the parties or transaction, the court did not discuss whether California possessed a materially greater interest, but proceeded directly to conclude that application of Virginia law would conflict with California's public policy. Assuming that Virginia had a substantial relationship, the court's conclusion with respect to the second prong would be inappropriate without determining whether California possessed a materially greater interest than Virginia.

Generally, with regard to conflict with a state's "fundamental policy," despite the presence within most states of cases holding that certain class action waivers are unenforceable, it is typically difficult to show

that applying a chosen state's laws are genuinely contrary to a fundamental policy of the plaintiff's preferred state's laws. The mere presence within one state of cases holding certain class action waivers to be invalid does not necessarily mean that the state has a fundamental policy against class action waivers.[20] Moreover, though states may make similar pronouncements regarding class action waivers, the pronouncements may mask greater underlying differences than apparent at first glance. For example, though Washington and Georgia courts have announced generally that class action waivers cannot be wielded as a means for companies to exculpate themselves from liability for wrongdoing, Georgia courts have adopted a narrower view regarding when a class action waiver has such an effect.[21]

On that note, evaluation of a state's "fundamental policy" with respect to class action waivers may depend on whether you are litigating in state or federal court. For example, the Eighth Circuit, applying Missouri law, held that a class action waiver was valid for various reasons, including the fact that the arbitration clause at issue was distinguishable from that considered by a Missouri appellate court, which determined that a class action waiver was unenforceable.[22] The court also stated that "[t]he decision of an intermediate state appellate court is not binding on a federal court that seeks to determine state law . . . and we do not know whether the Supreme Court of Missouri would adopt the reasoning of [the state appellate opinion] in its entirety."[23]

In *Gay v. CreditInform*, the Third Circuit similarly rejected the reasoning of two Pennsylvania Superior Court opinions that had invalidated class action waivers and discussed generally the policy favoring class actions as a means of vindicating the legal claims of individuals with small claims while preventing companies engaged in wrongdoing from insulating themselves from liability.[24] A critical consideration for the Third Circuit was the need to reconcile Pennsylvania law with federal law as set forth under the FAA. State law applied if it governed issues such as enforceability of contracts generally, but courts evaluating litigants' rights under arbitration agreements could neither construe those agreements in a manner different from non-arbitration agreements nor rely on the uniqueness of agreements to arbitrate as a basis for holding that enforcing arbitration agreements would be unconscionable.[25] According to the Third Circuit, the rulings in the Pennsylvania Superior Court cases violated this principle:

> To the extent, then, that [the state appellate court decisions] hold that the inclusion of a waiver of the right to bring judicial class actions in an arbitration agreement constitutes an unconscionable contract, they are not based "upon such grounds as exist at law or in equity for the revocation of any contract" pursuant to section 2 of the FAA, and therefore cannot prevent the enforcement of the arbitration provision in this case. . . .We . . . reject [the state appellate court decisions] . . . as there is no escape from the fact that they deal with agreements to arbitrate, rather than with contracts in general. . . . It would be sophistry to contend . . . that the Pennsylvania cases do not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." . . . After all, though the Pennsylvania cases are written ostensibly to apply general principles of contract law, they hold that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate. A finding that the arbitration provisions in those cases are unconscionable can be reached only by parsing the provisions themselves to determine what they provide.[26]

Thus, the reasoning in *Gay* is an example of a useful argument for the litigant seeking to persuade the court that unhelpful state law cases addressing class action waivers should be distinguished or disregarded. ■

Endnotes

1. Harris v. Green Tree Fin. Corp., 183 F.3d 173, 178–79 (3d Cir. 1999), quoted in Gay v. CreditInform, 511 F.3d 369, 388 (3d Cir. 2007); accord Weinstein v. AT&T Mobility Corp., No. 07-2880, 2008 U.S. Dist. LEXIS 35666, at *9 (E.D. Pa. Apr. 30, 2008).
2. 9 U.S.C. § 2
3. *See, e.g.*, Doctor's Assocs. v. Casarotto, 517 U.S. 681, 686–87 (1996); Lozano v. AT&T Wireless Servs., 504 F.3d 718, 725 (9th Cir. 2007); Dale v. Comcast Corp., 498 F.3d 1216, 1219 (11th Cir. 2007).
4. *See* Scott v. Cingular Wireless, 161 P.3d 1000, 1008 (Wash. 2007); accord Shroyer v. New Cingular Wireless Servs., 498 F.3d 976, 990 (9th Cir. 2007); *see also* Crandall v. AT&T Mobility, LLC, No. 07-750-GPM, 2008 U.S. Dist. LEXIS 55280, at *22 (S.D. Ill. July 18, 2008) ("The purpose of the FAA is to put arbitration agreements on even footing with other contracts, and any doubts concerning the scope of arbitrability are resolved in favor of arbitration. . . . But this does not change the fact that state law principles govern both whether an arbitration agreement exists and whether there are defenses to the validity of such agreement.").
5. *See Gay*, 511 F.3d at 388–89.
6. *Id.* at 389–90 (quoting Kruzits v. Okuma Machine Tool, Inc., 40 F.3d 52, 55 (3d Cir. 1994)); *see also* Kaltwasser v. Cingular Wireless LLC, No. C 07-00411, 2008 U.S. Dist. LEXIS 68601, at **4–5 (N.D. Cal. Aug. 22, 2008) (applying section 187 of the Restatement to conclude California rather than Virginia law applied); Davis v. Dell, Inc., No. 07-630 (RBK), 2008 U.S. Dist. LEXIS 62490 (D.N.J. Aug. 15, 2008) (noting New Jersey follows the Restatement); McGinnis v. T-Mobile USA, Inc., No. C08-106Z, 2008 U.S. Dist. LEXIS 65779, at **8–9 (W.D. Wash. July 22, 2008) (stating that Washington follows section 187 to resolve conflict of law problems where parties contractually agreed to choice of law).
7. Halprin v. Verizon Wireless Servs., LLC, No. 07-4015 (JAP), 2008 U.S. Dist. LEXIS 28840, at *10 (D.N.J. Apr. 8, 2008).
8. *Id.* at **10–11.
9. *See, e.g., Gay*, 511 F.3d at 390 (holding Virginia had a substantial relationship to the parties or dispute because service provider resided within Virginia); Davis, 2008 U.S. Dist. LEXIS 62490, at *10 (finding little difficulty with conclusion that Texas, where Dell, Inc., resided, possessed a substantial relationship to Dell, Inc., and the transaction).
10. *See, e.g., McGinnis*, 2008 U.S. Dist. LEXIS 65779, at **11–12.
11. *Gay*, 511 F.3d at 390.
12. *McGinnis*, 2008 U.S. Dist. LEXIS 65779, at **10–11 (footnote omitted).
13. *Id.* at **11–13 & n.13. On the other hand, when determining the potential of conflict between Washington and Minnesota law, the court emphasized that the party seeking the application of another state's laws bore the burden to show there was a conflict, which the defendant had been unable to do. *Id.* at **14–15.
14. *Id.* at *2.
15. *See Kaltwasser*, 2008 U.S. Dist. LEXIS 70996, at *6.
16. *See id.* at *6.
17. *Id.* at *8. The court also held that the choice-of-law provision was ambiguous and was most logically read to mean the consumer's billing address at the time he entered into the contract. *See id.* at **11–12 n.4.
18. *Id.* at **8–9 (citations omitted).
19. *Id.* at **9–10 (citations omitted).
20. *See Davis*, 2008 U.S. Dist. LEXIS 62490, at *10 (stating that Muhammad v. County Bank of Rehoboth Beach, 912 A.2d 88 (N.J. 2006), which invalidated a class action waiver, did not stand for the proposition that all such waivers were unenforceable under New Jersey law).
21. *See McGinnis*, 2008 U.S. Dist. LEXIS 65779, at *5 (noting conflict between Washington and Georgia law regarding class action waivers).
22. *See* Pleasants v. Am. Express Co., No. 07-3235, 2008 U.S. App. LEXIS 19175, at **12–14 (8th Cir. Sept. 9, 2008).
23. *See id.* at *12 (citation omitted).
24. *See Gay*, 511 F.3d at 392–93 (distinguishing and rejecting Lytle v. CitiFin. Servs., Inc., 810 A.2d 643 (Pa. Super. Ct. 2002), and Thibodeau v. Comcast Corp., 912 A.2d 874 (Pa. Super. Ct. 2006)).
25. *See id.* at 394 (citing Perry v. Thomas, 482 U.S. 483, 492 (1987)).
26. *Id.* at 394–95 (citation omitted); accord Weinstein, 2008 U.S. Dist. LEXIS 35666, at **12–13 (applying *Gay*).

ADR Alert: A New Take on the Arbitration of Claims Against Non-signatories to an Agreement to Arbitrate

By Manjit S. Gill Esq.

In *Sokol Holdings, Inc. v. BMB Munai, Inc.*,[1] the Second Circuit Court of Appeals tries once more to clarify when claims against non-signatories to an arbitration agreement will be properly referable to arbitration.

Background to Dispute

In this dispute, Sokol Holdings, Inc., (Sokol) entered a contract with Tolmakov Toleush Kalmukanovitch (Tolmakov) to purchase 70 percent of Tolmakov's 90 percent interest in Emir Oil LLP in Kazakhstan. This contract contained a provision that required all disputes arising from the contract to be arbitrated in Kazakhstan:

> The Parties shall resolve all disputes and disagreements arising from this Agreement through negotiations. Should the disputable issue be unsolved through negotiations within 30 days upon its arousal, the Parties shall transfer the disputable issue for its resolution at the International Arbitration Court of the Republic of Kazakhstan, to one or several arbitrators according to the regulations.[2]

The defendant in the lawsuit, BMB Munai, Inc. (BMB), was charged by Sokol with tortious interference with Sokol's contract with Tolmakov.[3] BMB was, of course, not a signatory to the arbitration agreement.[4]

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Proceedings Before Trial Court

BMB moved the federal district court under the Federal Arbitration Act, 9 U.S.C. § 3, to stay or dismiss the lawsuit, pending arbitration in Kazakhstan (even though BMB was not a signatory to that arbitration agreement). The trial court denied BMB's motion, and BMB appealed to the Second Circuit.[5]

Second Circuit's Decision

Before the Second Circuit, BMB argued that Sokol should be estopped from suing, rather than arbitrating, its claims against BMB because Sokol's claims were "intertwined" with the contract that contained the arbitration agreement, and the factual allegations made by Sokol in support of those claims "touch matters" covered by the contract that contains the arbitration agreement. BMB then argued that if some, but not all, of the claims against BMB were to be arbitrated, the court should stay the claims in the lawsuit pending the arbitration.[6]

The Second Circuit rejected BMB's estoppel argument. BMB relied upon a prior Second Circuit decision, *JLM Indus., Inc. v. Stolt-Nielsen SA*,[7] to argue to the court that:

> [A] non-signatory to an arbitration agreement can compel a signatory to arbitrate a dispute "where a careful review of 'the relationship among the parties, the contracts they signed . . . and the issues that had arisen' among them discloses that 'the issues the non-signatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed."[8]

The *Sokol* court held that BMB read too much into its own precedent. According to the *Sokol* court, the *JLM* decision did not set forth a "standard" for estoppel, but merely recited some possible circumstances in which it would be fair to say that a signatory would be estopped from refusing to arbitrate a dispute with a non-signatory. In other words, apart from "intertwined" factual issues, estoppel would only be warranted if there was a particular type of relationship among the parties to the dispute that warranted estoppel.[9]

What type of relationship would qualify? After reviewing several other precedents, none of which explicitly held that a certain set of criteria would be necessary to estop the signatory from suing a non-signatory in court, the court held that the touchstone factor was "consent," i.e., the relationship between the signatory and the non-signatory must demonstrate that both parties knew and/or consented by their actions in connection with the contract that included the arbitration agreement to have their disputes also arbitrated rather than litigated.[10]

In this case, BMB argued that, as a result of BMB's close relationship with Tolmakov, the original party with Sokol to the contract containing the agreement to arbitrate, it should be able to compel arbitration under that same agreement. The court, however, took note of how this relationship arose between BMG and Tolmakov (namely, as Sokol alleged, BMG had wrongfully interfered with Sokol's relationship with Tolmakov to effectively take Tolmakov's place in the transaction), and concluded that the manner in which the relationship between BMG and Tolmakov originated undercuts any argument that Sokol consented to this relationship, and in turn, consented to arbitrating disputes with BMG. As a result, for all the claims, other than the claim for specific performance, the court affirmed the district court's denial of BMB's motion to stay or dismiss the action pending arbitration.[11]

That left one remaining count: the count for specific performance. With respect to this count, the court reversed the district court. Because a count for specific performance against BMB of the contract presupposes that BMB should be treated as a party to that contract, the court held that all of the provisions of that contract

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Drafting Principles

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To address this concern, it is worth considering a class action waiver when drafting an arbitration provision (particularly in contracts when many consumers may be bound by the agreement in virtually the same form). Below is an example of a class action waiver that might be included in an arbitration agreement.[2]

> No arbitrator or court may order, permit, or certify a class action, representative action, private attorney-general litigation, or consolidated arbitration in connection with the Contract or this Arbitration Agreement. No arbitrator or court may order or permit a joinder of parties in connection with this Arbitration Agreement, except for a co-owner of the Account, unless both you and we consent to such joinder in writing. By accepting this Arbitration Agreement, you agree to waive the right to initiate or participate in a class action, representative action, private attorney-general litigation, or consolidated arbitration related to the Contract or your Account.

Because class action waivers are controversial[3] and have even resulted in the invalidation of arbitration as a viable option to resolve disputes in certain circumstances, this article suggests principles to keep in mind when drafting an arbitration agreement to ensure the best odds of having the class action waiver survive a challenge in an unfriendly jurisdiction and to maximize the likelihood that arbitration agreements are enforced "according to their terms," as U.S. Supreme Court precedent dictates.[4]

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What Is the Claim?

One of the most important parts of an arbitration agreement is the definition of "claim." Typically, a broad definition of "claim" is chosen so that the largest possible variety of claims be made subject to resolution in arbitration rather than in court. However, there may be value in reserving court jurisdiction for claims and issues relating to the enforceability or construction of the class action waiver itself.

This issue (and the ongoing strategic debate as to whether the arbitrator should be permitted to decide issues relating to the class action waiver) is of great significance given the inconclusive outcome of *Green Tree Financial Corp. v. Bazzle*.[5] Before *Green Tree*, many courts recognized that arbitration rarely was compatible with class adjudication. Therefore, if the arbitration provision did not specifically permit class relief, the arbitration provision would be construed to bar class actions, even if it did not address the issue at all.[6] In *Green Tree*, however, the Supreme Court ruled that when an arbitration agreement is silent, the arbitrator must determine whether class relief is allowed pursuant to the parties' arbitration agreement.[7]

Depending upon the jurisdiction in which disputes are most likely to arise, it may be preferable to leave the enforceability of the class action waiver provision to the arbitrator. However, a client might be uncomfortable with the uncertainty of leaving such a significant legal issue to an arbitrator with little prospect of meaningful judicial recourse of the arbitrator's decision when that decision will determine the very nature of the kind of arbitration that will take place.[8]

Indeed, for parties in arbitration, a class presents potentially the worst of all possible worlds: the procedural complexity and expense of class action practice with no appellate check on a runaway award that, in the judicial setting, might be remitted. One option would be to incorporate an appellate process into the arbitral setting through the arbitration agreement, such as providing that an initial award by one arbitrator may be appealed to an appellate panel of three arbitrators.[9] Appeal of the initial arbitrator's award, however, must take place within the arbitral process itself pursuant to the arbitration agreement; the parties may not give the court an appellate task not recognized under the Federal Arbitration Act. In *Hall Street Associates, LLC v. Mattel, Inc.*, the Supreme Court recently ruled that an arbitration agreement may not redefine or expand a court's powers to review, vacate, modify, or correct a final arbitral award.[10] For example, the agreement may not say, "If the arbitrator determines that a class may be certified, the court shall review this determination on a de novo basis."[11]

Thus, because *Green Tree* recognizes that enforceability of a class action waiver is a potentially arbitrable issue, and because a ruling by the arbitrator finding that class arbitration is permissible will be subject to very restricted review in the post-award setting, drafters of arbitration agreements should seriously consider including language in the agreement to address this risk by stating, expressly, that the parties do not intend to allow the arbitrator to determine the issue.[12] An example of such language is as follows:

> Any claim, dispute, or controversy ('Claim') by either you or us against the other arising from or relating in any way to this Agreement or your Account, except for the validity, scope or enforceability of this Arbitration Agreement, shall, at the demand of any party, be resolved by binding arbitration.

Because arbitration is fundamentally a matter of consent, an express agreement *not* to arbitrate the validity of the class action waiver, but rather to allow its validity to be determined by a court, likely is enforceable.[13]

Severability

Related to the issue of claim definition is the question of whether a corporate defendant will want to submit to arbitration at all if the class action waiver provision is not enforced. With careful drafting, one can guard against the possibility of having the class action waiver stricken while still being compelled to engage in arbitration. The goal should be to ensure that if a court decides not to enforce the class action waiver, it will proceed to a complete denial of the motion to compel arbitration. The following modification to a contract's usual severability language should help to achieve this result:

> If any provision of this Contract or the Arbitration Agreement shall be found invalid or unenforceable, such a finding shall not affect the enforceability of the remaining provisions, which shall remain and continue in full force and effect, except that if the

Class Action Waiver set forth above in the Arbitration Agreement is invalidated in any action or proceeding in which the parties hereto are involved, then the entire Arbitration Agreement will be void with respect to that action or proceeding and such action or proceeding will proceed exclusively in court.

Choice of Law

Substantive state law governing the parties' relationship usually is determined by factors unrelated to the arbitration agreement. However, to the extent there is flexibility in choice of law (e.g., in the case of a corporation incorporated in Delaware but doing business in multiple jurisdictions), it is worth noting that the enforceability of class action waivers varies widely by state. Indeed, even in states that are perceived as hostile to class action waivers (such as California), they still may be upheld on choice-of-law grounds. *Discover Bank v. Superior Court*, decided in California, for example, is cited most often for the proposition that California views class action waivers unfavorably in the consumer setting.[14] Significantly, however, what is often neglected is that the California Supreme Court did not strike the particular class action waiver at issue but instead remanded the case for a choice-of-law finding. On remand (*Discover II*), the Court of Appeal found that, because the parties' transaction had a substantial relationship to the State of Delaware, and because Delaware had a materially greater interest than California in the outcome of the dispute, California should defer to Delaware law and enforce the class action waiver.[15] The California Supreme Court denied review, allowing the Court of Appeal's enforcement of the class action waiver to stand. Moreover, numerous trial courts in California have followed *Discover II* and enforced class action waivers when the contract contains a choice-of-law clause selecting non-California law.[16]

A Meaningful Alternative Must Be Offered

Perhaps the most critical factor in enforceability of an arbitration agreement is making sure that, as a whole, it offers both sides a fair opportunity to achieve a meaningful resolution of their dispute and adequately discloses the basic terms for conducting the arbitration. For example, in *Klussman v. Cross Country Bank*,[17] a class action waiver was not enforced because its only appearance in the arbitration agreement was by way of reference to an obscure rule of the arbitral forum. As the California Court of Appeal found, "[t]he waiver in this case is buried in a linguistic labyrinth within the rules of the chosen arbitral forum, available only to the most diligent consumer who Theseus-like must wind through a large number of rules and procedural requirements."

The arbitrator should have the same substantive decision-making powers as a court might have.

Accordingly, it may be valuable to preface the arbitration agreement (or perhaps the main contract itself) with a prominent legend, such as "This agreement contains an arbitration clause and a class-action waiver." Depending on the nature of the contract, it may be possible as well to obtain each party's initials on the arbitration agreement. For online contracts, similar forms of affirmative consent to the arbitration agreement also should be considered if technically feasible.

Moreover, there are many possible ways to ensure a fair (and tailored) arbitral process. For example, the arbitration agreement may state that the company will advance some or all of the costs of the arbitration, or that the consumer's ultimate responsibility for costs will be capped at some reasonable figure, perhaps calculated by reference to the typical costs that would have been incurred if the action were to have proceeded in court. The agreement also can require that the arbitrators possess specific experience (judicial or otherwise); common requirements are that an arbitrator be a retired judge or an attorney with at least 10 years of experience in practice. Depending on the industry, particular industry expertise also may be required. A housing developer may, for example, want to include language confirming that the arbitrator must have specific experience with construction defect matters or even have held a contractor's license in good standing for at least a specified number of years.

Another way to respond to criticism that arbitration is not a useful method of resolving disputes in which there is not a big controversy is to include a provision giving the consumer the right to elect to proceed in small claims court rather than arbitration.

In turn, to respond to the criticism that arbitration may be physically inconvenient to consumers, a provision stating that the place of arbitration shall be within the federal judicial district wherein the consumer's home is located also may be useful.

However, even though the substantive agreement may include liability limitations, only under rare circumstances should these be included as part of the arbitration agreement. The arbitrator should have the same substantive decision-making powers as a court might have. Thus, if the contract includes a liquidated damages provision or restricts punitive damages, in most circumstances, the arbitrator should have the same power that a judge might have to strike or limit enforcement of such clauses. Similarly, the agreement should not attempt to deny a plaintiff the right to recover reasonable attorney fees in a case where a statute would permit such recovery.

Consider Giving an Opt-Out

Finally, to respond to criticism that consumers are forced into class action waivers, it may be desirable to offer the consumer a penalty-free option to avoid the arbitration agreement altogether if the consumer gives prompt pre-dispute notice of his or her wish to proceed only in court, no matter what the dispute. Below is an example of such an opt-out notice:

> **Right to Reject Arbitration**
> You have the right to reject this arbitration agreement, but you must exercise this right promptly. If you do not wish to be bound by this Arbitration Agreement, you must notify us in writing within sixty (60) days after the date your Account is opened. You must send your request to: Arbitration Manager, [address]. The request must include your account number and a clear statement of intent, such as 'I reject the Arbitration Agreement in my Contract.'

It is worth noting that in *Gentry v. Superior Court*, an employment case, the

California Supreme Court struck down a class action waiver as unconscionable even though employees were given the opportunity to opt out.[18] There, however, multiple problems existed with the clause and its opt-out terms. In particular, the Court in *Gentry* reasoned that the arbitration agreement did not provide plaintiff an "authentic informed choice" in deciding whether to choose arbitration. The handbook explaining the employer's arbitration program was "markedly one-sided." Additionally, the explanation of arbitration provided to employees also "did not mention any of the additional significant disadvantages that this particular arbitration agreement had compared to litigation." The disadvantages included: a one-year statute of limitations, where applicable law allowed three to four years; limited back pay recoverable to one year from the date of the violation, in contrast to a three-year accrual period under applicable law; a $5,000 cap on punitive damage awards in "all employment-related legal disputes," even when exemplary relief was more broadly available in court; and a requirement that the parties "generally" bear their own attorney fees and provision for only discretionary fee awards, as compared with applicable statutory provisions authorizing fee-shifting for prevailing plaintiffs.[19] Further, the Court in *Gentry* reasoned that the employer "made unmistakably clear that [it] preferred that the employee participate in the arbitration program." The arbitration agreement's substantive limitations on employees' claims and remedies, coupled with the employer's "pro-arbitration stance" and unequal bargaining power, indicated that the arbitration agreement was "at the very least, not entirely free from procedural unconscionability."[20]

Conclusion

When properly drafted and utilized, arbitration agreements and class action waivers remain useful tools to manage disputes in an efficient manner. It is critical, however, that the terms of such provisions be crafted with care and in compliance with evolving case law to maximize the likelihood that they will be enforced. ■

Endnotes

1. *E.g.,* Federal Arbitration Act, 9 U.S.C. § 1 et seq.; California Arbitration Act, Cal. Civ. Proc. Code § 1280 et seq.; *see also* Preston v. Ferrer, __ U.S. __, 128 S. Ct. 978, 981 (Feb. 20, 2008); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).
2. The exact defined terms will depend upon the particulars of the substantive agreement at issue. For ease of reference, in this article, the term "Contract" will refer to the entirety of the substantive contract, while the term "Arbitration Agreement" will refer exclusively to the arbitration provision, which typically will be appended to or made part of the Contract.
3. *See, e.g.,* Kristian v. Comcast Corp., 446 F.3d 25, 57–58 (1st Cir. 2006); Dale v. Comcast Corp., 498 F.3d 1216, 1224 (11th Cir. 2007); Tillman v. Commercial Credit Loans, Inc., 362 N.C. 93, 103, 108–09, 655 S.E.2d 362 (N.C. 2008).
4. *See* Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 57 (1995).
5. *Green Tree,* 539 U.S. 444, 452–53, 123 S. Ct. 2402, 2407, 156 L. Ed. 2d 414 (2003).
6. *See* Johnson v. West Suburban Bank, 225 F.3d 366, 369 (3d Cir. 2000); Champ v. Siegel Trading Co., 55 F.3d 269, 276–77 (7th Cir. 1995); Government of the UK v. Boeing Co., 998 F.2d 68, 69 (2d Cir. 1993); American Centennial Ins. Co. v. Nat'l Cas. Co., 951 F.2d 107, 108 (6th Cir. 1991); Baesler v. Continental Grain Co., 900 F.2d 1193, 1195 (8th Cir. 1990); Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp., 873 F.2d 281, 282 (11th Cir. 1989) (per curiam); Del E. Webb Constr. v. Richardson Hosp. Auth., 823 F.2d 145, 150 (5th Cir. 1987), overruled on other grounds as stated in Pedcor Mgt. Co., Inc. Welfare Benefit Plan v. Nations Personnel of Texas, Inc., 343 F.3d 355, 363 (5th Cir. 2003); Weyerhaeuser Co. v. Western Seas Shipping Co., 743 F.2d 635, 637 (9th Cir. 1984).
7. *Green Tree*, 539 U.S. at 447, 453; *see also* Anders v. Hometown Mortgage Servs., Inc., 346 F.3d 1024, 1032–33 (11th Cir. 2003) (arbitrator, not court, must determine in the first instance whether contractual limitation on remedies awardable by arbitrator could be enforced).
8. The Federal Arbitration Act places severe restrictions on courts' ability to set aside or modify legally erroneous awards as important goals of the statute are to achieve speedy and definitive resolution of disputes between the parties. *See* 9 U.S.C. §§ 9–10. In fact, the few grounds for setting aside an award include corruption, manifest disregard of the law, which has been interpreted very narrowly, and an "evident material miscalculation of figures."
9. Any such arbitral appeal right also should be fully reciprocal. Case law restricts provisions limiting the right to appeal to a respondent against whom a very large award has been made. *See* Worldwide Ins. Group v. Klopp, 603 A.2d 788, 790 (Del. 1992).
10. __ U.S. __, 128 S. Ct. 1396, 1406 (Mar. 25, 2008).
11. It is worth noting, however, that in agreements governed exclusively by California law, such a provision arguably is enforceable pursuant to the California Supreme Court's recent decision in Cable Connection, Inc. v. DirecTV, Inc., No. S147767 (Cal. Aug. 25, 2008).
12. *See Cable Connection*, slip op. at 37 ("availability of class-wide arbitration" should be decided "as a matter of contract interpretation and arbitration procedure" under the particular rules of the arbitral organization selected).
13. *See* Steelworkers v. Warrior & Gulf Nav. Co., 363 U.S. 574, 582 (1960) ("arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit"); *see also* 9 U.S.C. § 11(b) (court may modify or correct an arbitration award if the arbitrator rules "upon a matter not submitted" pursuant to the parties' agreement).
14. *Discover Bank,* 36 Cal. 4th 148 (2005); *see, e.g.,* Coady v. Cross Country Bank, 299 Wis.2d 420, 451, 729 N.W.2d 732 (Wis. Ct. App. 2007) (citing *Discover Bank* for the proposition that a class action mechanism in the consumer context is necessary to vindicate substantive rights); Fiser v. Dell Computer Corp., 142 N.M. 331, 341, 165 P.3d 328 (N.M. Ct. App. 2007) (observing that under California law, as articulated in *Discover Bank,* class action waivers in consumer contracts may be unconscionable under certain circumstances); accord Shroyer v. New Cingular Wireless Servs., Inc., 498 F.3d 976, 981–82 (9th Cir. 2007); Lowden v. T-Mobile USA, Inc., 512 F.3d 1213, 1220 (9th Cir. 2008); Cooper v. QC Financial Services, Inc., 503 F. Supp. 2d 1266, 1288–90 (D. Ariz. 2007); Sherr v. Dell, Inc., No. 05 CV 10097(GBD), 2006 WL 2109436, at *5 (S.D.N.Y. Jul. 27, 2006); Scott v. Cingular Wireless, 160 Wash. 2d 843, 850, 161 P.3d 1000 (Wash. 2007); S.D.S. Autos, Inc. v. Chrzanowski, 976 So. 2d 600, 610 (Fla. App. Ct. 2007).
15. 134 Cal. App. 4th 886 (2005).
16. *See e.g.,* Omstead v. Dell, Inc., 473 F. Supp. 2d 1018, 1024 (N.D. Cal. 2007); Provencher v. Dell, Inc., 409 F. Supp. 2d 1196, 1201 (C.D. Cal. 2006).
17. *Klussman,* 134 Cal. App. 4th 1283, 1299 (2005).
18. Gentry v. Superior Court, 42 Cal. 4th 443, 472 (2007).
19. *Id.* at 470–71.
20. *Id.* at 471–72.

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To Arbitrate or Not to Arbitrate

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after Mattel leased property from Hall Street in Oregon and used the premises as a manufacturing facility. According to the lease, Mattel was required to indemnify Hall Street for any costs resulting from its failure, or the failure of its predecessors, to comply with environmental laws. Well water on the property showed high levels of trichloroethylene (TCE), which resulted from residue of manufacturing discharges by Mattel's predecessors.[2]

After Mattel gave notice of its intent to terminate the lease, Hall Street filed a suit in the U.S. District Court for the District of Oregon, demanding that Mattel indemnify it for costs of cleaning up the water contamination caused by the TCE on the property and also claiming that Mattel did not have the right to terminate its lease on the given date. The court held that termination of the lease was proper. However, after unsuccessful attempts to mediate the indemnification claim, the parties agreed to arbitrate the claim. The court approved the parties' arbitration agreement and entered it as an order. According to the arbitration agreement, the court was required to "vacate, modify, or correct any award . . . where the arbitrator's conclusions of law are erroneous."[3]

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After arbitration was held, the arbitrator decided for Mattel. In determining that no indemnification was due, the arbitrator deemed that the lease required Mattel to comply with federal, state, and local environmental laws but did not require compliance with the Oregon Drinking Water Quality Act (Oregon Act), which the arbitrator believed dealt with human health rather than the environment. On Hall Street's motion, the district court vacated the award by invoking the legal error review standard in the parties' arbitration agreement, holding that the arbitrator's decision that the Oregon Act was not an environmental law was legal error. On remand, the arbitrator treated the Oregon Act as an applicable environmental law and ruled for Hall Street. The district court upheld the award. The Ninth Circuit then reversed the confirmation of the award based upon its decision in *Kyocera Corp. v. Prudential-Bache Trade Services, Inc.*,[4] and held that sections 10 and 11 of the FAA provide the exclusive grounds for vacating and modifying arbitration awards and that arbitration agreements cannot modify or expand those grounds.[5]

The Supreme Court, by a six to three vote, agreed with the Ninth Circuit and held that the grounds for prompt vacatur and modification of arbitration awards established by the FAA are exclusive and may not be supplemented by contract. Sections 9, 10, and 11 of the FAA provide for expedited judicial review. Under section 9 of the FAA, a court "must grant [an order confirming an award] unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11."[6]

Section 10 lists four grounds for vacating an arbitration award, including:

> (1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[7]

Section 11 lists grounds for modifying or correcting an arbitration award, including:

> (a) where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award; (b) where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted; (c) where the award is imperfect in matter of form not affecting the merits of the controversy.[8]

Prior to the Supreme Court's ruling, circuits were split over whether the FAA's grounds for vacatur and modification of awards were exclusive or could be expanded by an agreement. The Ninth, Tenth, and (in dicta) Eighth Circuits held that the FAA's grounds for expedited vacatur and modification are exclusive, while the First, Third, Fifth, Sixth, and (in dicta) Fourth Circuits held that parties may contract for broader judicial review.[9]

The Court noted that the "text compels a reading of §§ 10 and 11 categories as exclusive," and the statutory grounds cannot be expanded to "legal review generally" since "a statute with no textual hook for expansion cannot authorize contracting parties to supplement review for specific instances of outrageous conduct with review for just any legal error. 'Fraud' and a mistake of law are not cut from the same cloth."[10] Moreover, the Court noted that section 9 of the FAA is not flexible in its language and "unequivocally tells courts to grant confirmation in all cases, except when one of the 'prescribed' exceptions applies."[11] The Court concluded that sections 9 through 11 of the FAA "substantiat[e] a national policy favoring arbitration with just the limited review needed to maintain arbitration's essential virtue of resolving disputes straightaway. Any other reading opens the door to the full-bore legal and evidentiary appeals that can rende[r] informal arbitration merely a prelude to a more cumbersome and time-consuming judicial review process, and bring arbitration theory to grief in post-arbitration process."[12]

In support of its position, Hall Street advanced two main arguments. The first argument was that expandable judicial review has been the law since *Wilko v. Swan*.[13] *Wilko*, which was later overruled by *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[14] noted that "the interpretations of the law by the arbitrators in

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contrast to manifest disregard [of the law] are not subject, in the federal courts, to judicial review for error in interpretation."[15] The Court explained that Hall Street, as well as other circuits, have incorrectly interpreted this statement to mean that the Court in *Wilko* recognized "manifest disregard of the law" as an additional ground for vacatur. The Court noted that "manifest disregard of the law" may have referred to a new ground for vacatur, referred to section 10 "grounds collectively," or "may have been shorthand" for section 10 "subsections authorizing vacatur when the arbitrators were 'guilty of misconduct' or 'exceeded their powers.'" The Court, however, did not conclude which of these possible interpretations of *Wilko* was accurate. The Court noted that Hall Street inappropriately argued that since judges can add grounds to vacate or modify arbitration awards, then private parties can do so by contract as well.[16]

The second argument made by Hall Street was likewise rejected by the Court. Hall Street urged that because arbitration is a creature of contract, the agreement for expanded legal review should prevail. "While the FAA permits parties to contract for the way in which arbitrators are chosen, their qualifications, which issues are arbitrable, and which procedure and substantive law should govern the arbitration proceedings, the FAA compels a reading of sections 10 and 11 as being exclusive categories." The Court refused to expand the stated grounds to permit evidentiary and legal review generally.[17]

The Court's ruling in *Hall Street Associates* encourages expedited judicial review of arbitration awards. Although it ruled that the parties may not agree to non-statutory grounds for vacating or modifying an arbitration award, it did not close the door on "more searching review based on authority outside the statute."[18] Nevertheless, by prohibiting parties to a contract governed by the FAA from expanding the scope of judicial review, the Court has provided the same parties an incentive premised on finality and predictability to choose to resolve their disputes by arbitration, knowing that the possible bases for judicial review are specifically defined and exclusive.

Parties chose arbitration to resolve contract disputes because arbitration is a quick and cost-effective substitute to litigation. The Supreme Court's ruling encourages finality of arbitration awards and expediency of arbitration. Allowing parties to expand judicial review of arbitration awards would drag out the case, increase costs, and make arbitration a step before litigation rather than an alternative to litigation. Allowing arbitration awards to be vacated or modified only on the basis of the narrow statutory grounds provided for by the FAA makes arbitration more efficient.

Granted, some parties may be discouraged from choosing arbitration for fear that they will not be able to vacate or modify a decision by an arbitrator that is based on legal error, or they may conclude that they will be compelled to resolve their disputes in a manner that is not consistent with their initial intent when they submitted their dispute to arbitration, a point seized upon by the dissent in *Hall Street Associates*. Nevertheless, for the large majority seeking to resolve disputes by arbitration, these concerns will not be a sufficient deterrent.

> The Court noted that the FAA "establishes a national policy favoring arbitration when the parties contract for that mode of dispute resolution."

Preston v. Ferrer

The Supreme Court also recently decided in *Preston v. Ferrer*[19] that "when parties agree to arbitrate all questions arising under a contract," the FAA supercedes state laws that would grant primary jurisdiction to a judicial forum, as well as state laws that would require the referral of disputes to an administrative agency.

Preston v. Ferrer arose out of a dispute between Alex E. Ferrer, a television personality known as "Judge Alex," and Arnold M. Preston, an entertainment attorney in California. The parties entered into a contract that required arbitration of "any dispute . . . relating to the terms of [the contract] or the breach, validity, or legality thereof . . . in accordance with the rules [of the American Arbitration Association (AAA)]."[20]

Preston was seeking fees due under the contract and invoked the arbitration clause. A month after the demand for arbitration was made by Preston, Ferrer petitioned the California Labor Commissioner, asserting that the contract was invalid and unenforceable under the California Talent Agencies Act (TAA). According to the TAA, disputes must first be heard by the California Labor Commissioner before they can heard by a court on appeal. Ferrer claimed that the contract is void because Preston acted as an unlicensed talent agent in violation of the TAA. The California Labor Commissioner stated that Ferrer had stated a "colorable basis" to invoke the jurisdiction of the California Labor Commissioner but denied Ferrer's motion to stay arbitration because she did not have the authority to grant such relief. Ferrer thereafter filed a suit in the Los Angeles Superior Court to enjoin Preston from proceeding with arbitration, and Preston moved to compel arbitration. The state court denied Preston's motion to compel and enjoined arbitration "unless and until the Labor Commissioner determined that . . . she is without jurisdiction over the disputes between Preston and Ferrer." Preston appealed the state court's decision.[21]

While the appeal in the California court system was pending, the Supreme Court decided *Buckeye Check Cashing, Inc. v. Cardegna*,[22] holding that an arbitrator, and not a court, should consider challenges to validity of a contract that provides for arbitration. The California appeals court then affirmed the lower court's judgment in *Preston*, holding that under the TAA, the California Labor Commissioner has the "exclusive original jurisdiction over the dispute" and noting that *Buckeye* is "inapposite" because it "did not involve an administrative agency with exclusive jurisdiction over a disputed issue."[23]

The Supreme Court, in an eight to one decision, reversed the California appellate court's decision. The Court noted that the question was not whether the FAA preempted the TAA, but rather who decides—the arbitrator or the administrative agency—whether Preston acted as an unlicensed talent agent or as a personal

manager. If Preston was an unlicensed talent agent, as Ferrer argues, he would have violated the TAA and the contract would therefore be void. If however, Preston was a personal manager as he claims, the contract would not be governed by the TAA and would be valid and enforceable.[24]

The Court noted that the FAA "establishes a national policy favoring arbitration when the parties contract for that mode of dispute resolution" and that the national policy "appli[es] in state as well as federal courts and foreclose[s] state legislative attempts to undercut the enforceability of arbitration agreements."[25] The Court further noted that the "attacks on the validity of an entire contract, as distinct from attacks aimed at the arbitration clause, are within the arbitrator's ken."[26]

Although Ferrer attempted to distinguish the precedent set forth in *Buckeye*, the Court found Ferrer's attempts unconvincing. The Court found that the TAA was in conflict with the FAA because it granted the administrative agency exclusive jurisdiction to resolve the dispute and imposed "prerequisites to enforcement of an arbitration agreement that are not applicable to contracts generally."[27] Ferrer argued that the TAA does not bar arbitration, but instead simply postpones it until the administrative remedies were exhausted. The Supreme Court noted that "[a]rbi-tration, if it ever occurred following the Labor Commissioner's decision, would likely be long delayed, in contravention of Congress' intent to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible."[28] The Court further noted that "[a] prime objective of an agreement to arbitrate is to achieve streamlined proceedings and expeditious results" and that "[r]equiring initial reference of the parties' dispute to the Labor Commissioner would, at the least, hinder speedy resolution of the controversy."[29]

The Supreme Court also rejected Ferrer's argument that the conflict between the TAA and the arbitration clause should be overlooked because the California Labor Commissioner proceedings are administrative and not judicial. The Court held that the FAA trumps state laws that secure jurisdiction in judicial or administrative forums.[30]

In a final attempt to distinguish *Buckeye*, Ferrer relied on *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*,[31] which the Court also found unconvincing. The *Volt* decision is commonly used by parties in an effort to oppose arbitration. *Volt* involved a dispute between Volt Information Sciences (Volt) and Stanford University (Stanford) relating to a construction contract. Stanford sued Volt and two other companies that were involved in the construction but who were not parties to the contract. Volt demanded arbitration and Stanford moved for an order to stay arbitration. The state court stayed arbitration and the California appeals court affirmed that order. The construction contract between Volt and Stanford contained an arbitration clause. The contract was governed by California law and, as such, the appeals court held that it incorporated a California statute, which authorized the state court to "stay the court proceeding pending the outcome of the arbitration or to stay the arbitration pending the outcome of the court action."[32] The statute applied to "cases in which [a] party to [an] arbitration agreement is also a party to a pending court action . . . [involving] a third party [not bound by the arbitration agreement], arising out of the same transaction or series of related transactions."[33] The Supreme Court in *Volt* held that "the FAA did not bar a stay of arbitration pending the resolution of Stanford's Superior Court suit against Volt and the two companies not bound by the arbitration agreement."[34]

The FAA preempts state laws as well as agreements that interfere with the efficient resolution of disputes through arbitration.

Ferrer argues that its contract with Preston also contains a similar choice-of-law clause and therefore, the TAA, which refers the dispute to an administrative agency, should be applied. The Supreme Court noted that while in *Volt*, arbitration was stayed pending litigation involving third parties not bound by the arbitration agreement, Ferrer and Preston were both bound by their arbitration agreement as parties to that agreement. The Court therefore distinguished *Volt* because it involved non-parties to arbitration and held that it was inapplicable to the case at hand.

The Court further noted that it did not consider in *Volt* whether incorporation of AAA rules into the contract superseded the choice-of-law clause in that contract. The Court addressed that issue in *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*,[35] where it held that "the best way to harmonize [a New York choice-of-law clause and a clause providing for arbitration in accordance with NASD rules] was to read the choice-of-law clause to encompass substantive principles that New York courts would apply, but not to include [New York's] special rules limiting the authority of arbitrators."[36] The Court in *Preston* limited the reach of the *Volt* case and, following *Mastrobuono*, held that the "best way to harmonize" Ferrer and Preston's "adoption of the AAA rules and their selection of California law is to read the latter to encompass prescriptions governing the substantive rights and obligations of the parties, but not the State's special rules limiting the authority of arbitrators."[37]

Both cases show the Supreme Court's effort to endorse arbitration agreements and maintain the efficiency of arbitration. The FAA preempts state laws as well as agreements that interfere with the efficient resolution of disputes through arbitration. One of the hallmarks of the FAA is that it establishes a national policy favoring arbitration, and these cases demonstrate that the Supreme Court has no intention of diminishing the breadth of the FAA and the underlying motivation to encourage more disputes to be resolved by arbitration in lieu of litigation. ■

Endnotes

1. *Hall St. Assocs.*, 128 S. Ct. 1396 (2008).
2. *Id.* at 1400.
3. *Id.* at 1400–1401.
4. *Kyocera*, 341 F.3d 987 (2003).
5. *Supra* note 1 at 1401.
6. 9 USCS § 9.
7. 9 USCS § 10(a).
8. 9 USCS § 11.
9. *Supra* note 1 at 1403 (citations omitted).
10. *Supra* note 1 at 1404–1405.
11. *Supra* note 1 at 1405.

12. *Id.* (citations omitted).
13. *Wilko*, 346 U.S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953).
14. *Rodriguez*, 490 U.S. 477, 484, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989).
15. *Supra* note 13 at 436–437.
16. *Supra* note 1 at 1403–1404.
17. *Supra* note 1 at 1404.
18. *Supra* note 1 at 1406.
19. *Preston*, 128 S. Ct. 978 (2008).
20. *Id.* at 982.
21. *Id.*
22. *Buckeye,* 546 U.S. 440, 126 S. Ct. 1204 (2006).
23. Preston v. Ferrer, 145 Cal. App. 4th 440, 447, 51 Cal. Rptr. 3d 628, 634 (Cal. 2006).
24. *Supra* note 19 at 983.
25. *Id.* at 981, 983 (quotations omitted).
26. *Id.* at 981, 984.
27. *Id.* at 985.
28. *Id.* at 986 (quotations omitted).
29. *Id.*
30. *Id.* at 987.
31. *Volt,* 489 U.S. 468 (1989).
32. *Supra* note 19 at 987 (quotations omitted) (citing Cal. Civ. Proc. Code Ann. § 1281.2(c)).
33. *Id.*
34. *Supra* note 19 at 981, 988.
35. *Mastrobuono*, 514 U.S. 52 (1995).
36. *Supra* note 19 at 988–989 (quotations omitted) (citing *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 63-64 (1995)).
37. *Supra* note 19 at 989 (quotations omitted).

Informed Consent

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the meeting with a strategy for negotiation and tries to utilize information to leverage his or her position. Disputes are resolved by the court at trials, in evidentiary hearings, or by way of arguments of counsel before the court. Unfortunately, in cases involving children, the nature of the adversarial system is to place the parents at odds with each other in a contest to see who can "win" custody. Of course, the children are often the casualties in this type of battle.

To be sure, traditional litigation has its place. There are many examples: One spouse may have exclusive access to assets and information; one spouse may be a member of a closely held family business; one or both spouses may have significant mental health issues that may interfere with the ability to participate in an alternative process; or the couple may have a history of domestic violence, all of which may impede forthright dialogue about the pending issues and investigation of financial information.

Most clients seeking divorce counsel are traumatized, anxious, and feeling a sense of helplessness. As in the medical setting, these clients need to be fully informed of the options available, as well as the advantages and disadvantages of each approach, before they make a decision as to how to proceed. Very often, actions taken or not taken at the commencement of the case can determine the tone and tenor of not only the divorce case but also of the future of the reconstituted family. The needs of children are of paramount concern to the court and should also be of concern to the parents and their attorneys. Careful consideration of all options available to the couple should be the very first assistance provided by competent, caring family law practitioners. ■

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would apply to BMB in connection with a claim for specific performance, including the provision to arbitrate disputes under the contract (even though BMB was not a signatory).[12]

What are the lessons to be learned? First, if you want to thwart a non-signatory from participating in an arbitration, choose the causes of action that you want to pursue carefully. Second, if you are the non-signatory and want to compel arbitration, make sure your relationship with the signatory is truly consensual. ■

Endnotes

1. __ F.3d __, 2008 WL 4249201 (2d Cir. Sept. 18, 2008).
2. *Id.* at *7, n.1.
3. Sokol also sued BMB on several other theories, including a claim for specific performance to compel BMB to sell back an interest in the Emir oil wells that had been sold to BMB by Tolmakov.
4. *Id.*at *1.
5. *Id.* at *2.
6. *Id.*
7. 387 F.3d 163 (2d Cir. 2004).
8. *JLM,* 387 F.3d at 177.
9. *Id.* at 3.
10. *Id.* at 6.
11. *Id.* at 7.
12. *Id.*

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